

# University of Pennsylvania Law Review

FOUNDED 1852

Formerly  
American Law Register

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VOL. 139

DECEMBER 1990

No. 2

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## ARTICLES

### REPUBLICAN MOMENTS: THE ROLE OF DIRECT POPULAR POWER IN THE AMERICAN CONSTITUTIONAL ORDER

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*Those who profess to favor freedom and yet deprecate agitation, are people who want crops without plowing up the ground, they want rain without thunder and lightning.*

—Frederick Douglass<sup>1</sup>

*Even [political turbulence] is productive of good. It prevents the degeneracy of government, and nourishes a general attention to the public affairs. I hold it that a little rebellion now and then is a good thing, and as necessary in the political world as storms in the physical.*

—Thomas Jefferson<sup>2</sup>

*It is, in fact, at such moments of collective ferment that are born the great ideals upon which civilizations rest. The periods of creation or renewal occur when [people] for various reasons are led into a closer relationship with each other, when reunions and assemblies are most frequent, relationships better maintained and the exchange of ideas most active. . . . Once the critical moment has passed, the social life relaxes, intellectual and emotional intercourse is subdued, and individuals fall back to their ordinary level.*

—Emile Durkheim<sup>3</sup>

## INTRODUCTION

The image of thunder storms seems out of place in constitutional discourse. We are accustomed to the more solid metaphors of governmental machinery or the "body politic." If, as John Adams envisaged, government is a "complicated piece of machinery, the nice and exact adjustment of whose springs, wheels, and weights" is poorly understood by the people,<sup>4</sup> then a stormy popular upheaval could only upset the adjustment. Surely no self-respecting physician of the body politic would willingly expose it to the turbulent winds of popular rebellion.

The mechanical and biological metaphors reflect a tendency to view the constitutional order as a stable system, and the mission of

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<sup>1</sup> P. FONER, *FREDERICK DOUGLASS* 11 (1964) (quoting Frederick Douglass).

<sup>2</sup> Letter from Thomas Jefferson to James Madison (Jan. 30, 1787), in 11 *THE PAPERS OF THOMAS JEFFERSON* 92, 93 (J. Boyd ed. 1955) [hereinafter *JEFFERSON PAPERS*].

<sup>3</sup> E. DURKHEIM, *SOCIOLOGY AND PHILOSOPHY* 91-92 (1965).

<sup>4</sup> Letter from John Adams to Thomas Jefferson (May 19, 1821), in 10 *THE WORKS OF JOHN ADAMS* 398 (C. Adams ed. 1856).

constitutional law as promoting the smooth functioning of that system. For the past several decades, this tendency toward systems-thinking has taken the form of liberal or interest group pluralism.

At first, liberal pluralism embodied a happy convergence of descriptive and prescriptive visions. Not only were American politics characterized by interest group bargaining, but that was the best possible state of affairs. As Madison had predicted, a polity divided into numerous competing interest groups would not give rise to a single dominating faction.<sup>5</sup> All groups would be able to press their concerns and make alliances, thereby ensuring that their interests received fair consideration.<sup>6</sup> It followed that the legislative products of this fair process should be broadly construed to achieve their purposes,<sup>7</sup> and that the power of judicial review need only be exercised to correct occasional malfunctions.<sup>8</sup>

In the short decade since John Ely and Jesse Choper "perfect[ed]" this view,<sup>9</sup> interest group bargaining has fallen so low in scholarly esteem that it can now be called a "disease" in the pages of a law journal.<sup>10</sup> Although the system still has its defenders, it is no exaggeration to say that contemporary legal scholarship is "haunted by the idea that statutes are nothing more than deals between contending interest groups."<sup>11</sup>

<sup>5</sup> See THE FEDERALIST No. 10, at 83 (J. Madison) (C. Rossiter ed. 1961).

<sup>6</sup> Initially, it was enough that pluralism would serve as a defense against totalitarianism. See D. RODGERS, *CONTESTED TRUTHS: KEYWORDS IN AMERICAN POLITICS SINCE INDEPENDENCE* 209 (1987). Claims of fairness and efficiency were added later. See, e.g., D. TRUMAN, *THE GOVERNMENTAL PROCESS: POLITICAL INTERESTS AND PUBLIC OPINION* 510-15 (1951) (contending that citizens' overlapping membership in interest groups provides a "balance wheel" in the system, and that pluralist politics are characterized by "widespread, frequent recognition of and conformity to the claims of . . . unorganized interests").

<sup>7</sup> See H. HART & A. SACKS, *THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW* 1156-57 (tentative ed. 1958). On the influence of interest group pluralism on Hart & Sacks and the Legal Process school, see Eskridge, *Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 74 VA. L. REV. 275, 281-83 (1988); Minda, *Interest Groups, Political Freedom, and Antitrust: A Modern Reassessment of the Noerr-Pennington Doctrine*, 41 HASTINGS L.J. 905, 940-41 (1990).

<sup>8</sup> See J. CHOPER, *JUDICIAL REVIEW AND THE NATIONAL POLITICAL PROCESS* (1980); J. ELY, *DEMOCRACY AND DISTRUST* (1980).

<sup>9</sup> See Parker, *The Past of Constitutional Theory—And Its Future*, 42 OHIO ST. L.J. 223, 223 (1981) (analyzing J. CHOPER, *supra* note 8; J. ELY, *supra* note 8).

<sup>10</sup> See Epstein, *Modern Republicanism—Or the Flight From Substance*, 97 YALE L.J. 1633, 1641 (1988). For an early and influential diagnosis of the disease, see E. SCHATTSCHEIDER, *THE SEMI-SOVEREIGN PEOPLE* (1960).

<sup>11</sup> Farber & Frickey, *The Jurisprudence of Public Choice*, 65 TEX. L. REV. 873, 925 (1987).



While the pluralist prescription has thus been seriously undermined, its descriptive vision is more firmly entrenched than ever. The highly influential economic (or "public choice") theory of legislation depicts the polity as a political marketplace dominated by special interest groups.<sup>12</sup> For most citizens, the benefits of political participation do not exceed the costs.<sup>13</sup> Hence, it would be "irrational" for them to engage in political action.<sup>14</sup> With most of the citizenry thus relegated to the sidelines, the field is left open for the few groups that are able, because of advantages like compactness and wealth, to overcome the problem of organizational costs.<sup>15</sup>

For those who are not impressed with the economic diagnosis, there is always the problem of size. The proponents of the "republican revival," for example, are not especially concerned about the purported irrationality of collective action; according to republican theory, political activism can be a source of happiness in itself.<sup>16</sup> Unfortunately, the republican ideal of deliberative democracy was designed for societies the size of city-states. The notion that ordinary citizens can engage in deliberative self-government seems utopian in a polity as large as the United States.<sup>17</sup>

This pessimism is partly a product of systems-thinking. If we set ourselves the task of designing a system that can maintain a steady, high level of nationwide political participation, then the prospects for democracy are indeed bleak. Locked in systems-thinking, we cannot conceive of alternatives to interest group politics that are not themselves capable of continuous, smooth functioning. Hence, it is not surprising that the most ambitious proposals for reform rely not on the uncontrollable remedy of popular power, but on the free market system<sup>18</sup> or the "independent" judiciary.<sup>19</sup> Those who

<sup>12</sup> See Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223, 224 (1986).

<sup>13</sup> The pathbreaking work explaining the rationale for individual inaction is M. OLSON, *THE LOGIC OF COLLECTIVE ACTION* (1965).

<sup>14</sup> See *infra* note 118 and accompanying text.

<sup>15</sup> See M. OLSON, *THE RISE AND DECLINE OF NATIONS* 34-35 (1982). For additional discussion and sources, see *infra* notes 135-39 and accompanying text.

<sup>16</sup> See H. ARENDT, *THE HUMAN CONDITION* 22-69 (1958); *infra* notes 120-21 and accompanying text.

<sup>17</sup> For a classic treatment of the difficulty of achieving republican ideals in a state too large for direct democracy, see J. ROUSSEAU, *The Social Contract*, in *THE SOCIAL CONTRACT AND DISCOURSES* 1, 93-96 (G. Cole ed. 1950). The problem of size is discussed *infra* notes 39-71 and accompanying text.

<sup>18</sup> Richard Epstein, for example, urges the courts to strike down legislation that infringes common law economic rights. See R. EPSTEIN, *TAKINGS: PRIVATE PROPERTY*

are not so sanguine about markets or courts seem condemned to apologize for suggesting "disturbingly modest weapons with which to confront the seemingly awesome problem posed by special interest groups."<sup>20</sup>

A glance at history suggests that systems-thinking ignores a major part of the American political experience. Our history has from the outset been characterized by periodic outbursts of democratic participation and ideological politics. And if history is any indicator, the legal system's response to these "republican moments"<sup>21</sup> may be far more important than its attitude toward interest group politics. The most important transformations in our political order—independence, abolition, the rise of economic regulation, the integration of the industrial working class into

AND THE POWER OF EMINENT DOMAIN (1985); Epstein, *Taxation, Regulation, and Confiscation*, 20 OSGOOD HALL L.J. 433, 437-38 (1982).

<sup>19</sup> Among the new republicans, for example, the most far-reaching proposal is Frank Michelman's suggestion that instead of deferring to the elected branches, the Supreme Court should itself model "the active self-government that citizens find practically beyond reach." Michelman, *Foreword: Traces of Self-Government*, 100 HARV. L. REV. 4, 74 (1986). For a proposal grounded in feminist theory that would similarly call upon the Court to "enact and preside over" the normative dialogue, see Minow, *Foreword: Justice Engendered*, 101 HARV. L. REV. 10, 95 (1987).

<sup>20</sup> Macey, *supra* note 12, at 268; see also Farber & Frickey, *supra* note 11, at 926 (apologizing for failing to provide a "panacea" for the problem of special interest groups). Although some of these weapons would undoubtedly be useful, few rely on the power of democracy. Instead, they propose incremental transfers of power from the legislative or executive branches to the judiciary or the private market. See, e.g., Sunstein, *Interest Groups in American Public Law*, 38 STAN. L. REV. 29, 69-72 (1985) [hereinafter Sunstein, *Interest Groups*] (recommending that the level of judicial scrutiny in rationality review be heightened); Macey, *supra* note 12, at 264-65 (suggesting the revival of the principle that a statute in derogation of the common law should be narrowly construed because it "limits the scope of inefficient statutes by protecting the domain of efficient common law rules from encroachment by ill-conceived, special interest statutes"); Mashaw, *Constitutional Deregulation: Notes Toward a Public, Public Law*, 54 TUL. L. REV. 849, 873-75 (1980) (recommending the expansion of suspect or quasi-suspect classification analysis to all politically disadvantaged groups); Ackerman, *Beyond Carolene Products*, 98 HARV. L. REV. 713, 742 (1985) (same); Eskridge, *Public Values in Statutory Interpretation*, 137 U. PA. L. REV. 1007, 1093 (1989) (suggesting that statutes should be construed so as to effectuate "substantive values—such as nondiscrimination, first amendment concerns, and environmental policy"); Sunstein, *Beyond the Republican Revival*, 97 YALE L.J. 1539, 1583 (1988) [hereinafter Sunstein, *Republican Revival*] (approving of "a judicial perception that statutes should be construed so that the aggregate social benefits are proportionate to the aggregate social costs"); Sunstein, *Constitutionalism After the New Deal*, 101 HARV. L. REV. 421, 463-78 (1987) [hereinafter Sunstein, *Constitutionalism*] (arguing that courts should more closely scrutinize administrative action); Macey, *supra* note 12, at 263-64 (same).

<sup>21</sup> For readers who cannot wait for a fully developed presentation of this construct, a definition is located *infra* text accompanying notes 106-10.

capitalist democracy, and the extension of formal legal rights to women and minorities—were brought on by republican moments.

Not only do republican moments upset systems-thinking, they also violate the axiom that ours is a system of *representative* government in which, according to Publius and others, the people have no direct role.<sup>22</sup> During republican moments, social movements exert direct popular power on governmental and private institutions. Before proceeding further, it will be useful to specify what is meant by the term “Direct Popular Power” in this essay.

“Direct” means outside the formal structure of representative democracy. An example in pure form would be the replacement of representative institutions by assemblies of “the whole people.” Less pure and more common examples include efforts to secure government or private action by mass demonstrations, civil disobedience, boycotts, or other nonelectoral means.

“Popular,” as used here, is the opposite of aristocratic or elitist. A form of political participation is popular if it is not limited to elites. Again, the example in pure form would be an assembly of the whole people. And again, less pure but more common examples include demonstrating, withholding patronage, and refusing to obey unjust laws. Here, however, the defining characteristic is not directness, but inclusiveness. A form of participation may be popular but not direct—as in the case of voting for representatives, or direct but not popular—as in the case of bribing public officials or threatening to move a factory.

Max Weber’s definition of power, which accords with common-sense understandings, is adequate for present purposes. According to Weber, power is “the possibility of imposing one’s will upon the behavior of other persons.”<sup>23</sup> Power may be, but need not be, exercised through economic or physical coercion. The “power of persuasion” is also, as the phrase indicates, a form of power.<sup>24</sup>

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<sup>22</sup> See THE FEDERALIST NO. 10 (J. Madison).

<sup>23</sup> M. WEBER, MAX WEBER ON LAW IN ECONOMY AND SOCIETY 323 (M. Rheinstein trans. 2d ed. 1954).

<sup>24</sup> Indeed, in the emerging post-industrial era, organization and persuasion may be more potent sources of power than property or the means of violence. See, e.g., J. GALBRAITH, THE ANATOMY OF POWER 131-59 (1983) (arguing that traditional sources of power, such as property, are effective mainly in terms of the amount of “social conditioning” their possessors can buy or otherwise bring to bear in order to attain their ends). Although this form of power may be exerted subtly—sometimes so subtly that the target is unaware of its exercise—we are more concerned here with the overt varieties. Hidden conditioning is a tool of established elites. Popular movements lack the centralization, discipline, and secrecy necessary to engage in

Direct popular power should not be equated with the formal mechanisms of initiative and referendum. The Supreme Court's view that the referendum procedure is a "classic demonstration of 'devotion to democracy'" that "ensures that *all the people* of a community will have a voice in a decision"<sup>25</sup> may hold for highly politicized electorates, but referendum voting—unlike more active forms of participation like demonstrating or boycotting—can also make law without mobilizing popular activity or even attracting much public attention. In the common situation of large and apathetic electorates, referendum outcomes may be less reflective of the popular will than of the amount of campaign spending by competing elites.<sup>26</sup> Thus, although referenda can function as a form of direct popular power, they are by no means *the* form or even necessarily the most democratic form.

Part I of this Article addresses the problem of popular democracy from the republican perspective and concludes that the problem of size has channeled the new republicans toward elitist solutions. Part II develops the theory of republican moments. Part III suggests that in bringing on republican moments, direct popular power provides a partial corrective not only to the problem of size, but also to the main concerns posed by the critique of interest group pluralism. Part IV finds a constitutional home for the politics of republican moments in the first amendment. Part V applies the theory of republican moments to some first amendment problems, while Part VI discusses its implications for statutory construction and administrative law.

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subtle manipulation; of necessity they conduct their politics out of doors.

<sup>25</sup> *Eastlake v. Forest City Enterprises, Inc.*, 426 U.S. 668, 678-79 (1976) (quoting *James v. Valtierra*, 402 U.S. 137, 141, 143 (1971)). For criticisms of *Eastlake* on this point, see Michelman, *Political Markets and Community Self-Determination: Competing Judicial Models of Local Government Legitimacy*, 53 IND. L.J. 145, 185 (1978) and Sager, *Insular Majorities Unabated: Warth v. Seldin and City of Eastlake v. Forest City Enterprises, Inc.*, 91 HARV. L. REV. 1373, 1408-11, 1414-15 (1978).

<sup>26</sup> See T. CRONIN, *DIRECT DEMOCRACY: THE POLITICS OF INITIATIVE, REFERENDUM, AND RECALL* 109-13 (1989) (summarizing the empirical literature and concluding that money is extremely effective in defeating referendum initiatives, especially when it is used to purchase "tricky and subtle" advertising); Berg & Holman, *The Initiative Process and its Declining Agenda-Setting Value*, 11 LAW & POL'Y 451, 451-52 (1989) (observing that the initiative qualifying process has become "professionalized," resulting in increased dominance by well-financed interest groups).

# I. POPULAR VS. ELITIST REPUBLICANISM ON DIRECT POPULAR PARTICIPATION

By the early 1980s, interest group pluralism was already under heavy attack in the law reviews.<sup>27</sup> The critics, however, lacked an alternative vision of comparable scope. For aficionados of the free market, this posed no particular difficulty; the obvious solution was to remove decisions from the political realm and entrust them to the market.<sup>28</sup> However, to critics who favored positive government, the lack of an alternative vision presented a serious problem. To fill the gap, Frank Michelman and Cass Sunstein turned to the classical republican tradition of political thought, including its elements of relative equality of wealth, direct citizen participation, and civic virtue.<sup>29</sup>

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<sup>27</sup> The publication of Ely's and Choper's books, for example, aroused a storm of criticism. See, e.g., *Symposium: Judicial Review Versus Democracy*, 42 OHIO ST. L.J. 1 (1981) (featuring fifteen articles criticizing Ely's and Choper's books); Estreicher, *Platonic Guardians of Democracy: John Hart Ely's Role For the Supreme Court in the Constitution's Open Texture* (Book Review), 56 N.Y.U. L. REV. 547 (1981) (criticizing Ely for his argument that the Court should use judicial review only to correct the excesses of interest group politics); Sager, *Constitutional Triage* (Book Review), 81 COLUM. L. REV. 707, 719 (1981) (criticizing Choper for his "too comfortabl[e]" acceptance of the present standard of judicial deference to the legislative and executive branches).

<sup>28</sup> See *supra* note 18.

<sup>29</sup> This project was suggested by Richard Parker in an article critiquing Ely. See Parker, *supra* note 9, at 258 n.146. For Michelman's and Sunstein's pioneering efforts, see Michelman, *supra* note 19; Sunstein, *Interest Groups*, *supra* note 20, at 29. Suzanna Sherry has suggested that the republican revival shares common themes with feminist theory. See Sherry, *Civic Virtue and the Feminine Voice in Constitutional Adjudication*, 72 VA. L. REV. 543 (1986).

The rise of republican legal scholarship is one part of a broader revival of interest in the republican tradition, popularized in the best-seller *Habits of the Heart*. R. BELLAH, R. MADSEN, W. SULLIVAN, A. SWIDLER & S. TIPTON, *HABITS OF THE HEART: INDIVIDUALISM AND COMMITMENT IN AMERICAN LIFE* (1985) [hereinafter *HABITS OF THE HEART*]. Influential works of political theory in this vein include: B. BARBER, *STRONG DEMOCRACY: PARTICIPATORY POLITICS FOR A NEW AGE* (1984); C. PATEMAN, *PARTICIPATION AND DEMOCRATIC THEORY* (1970); and M. SANDEL, *LIBERALISM AND THE LIMITS OF JUSTICE* (1982). For historical works uncovering the American republican tradition, see, for example, J. APPLEBY, *CAPITALISM AND A NEW SOCIAL ORDER: THE REPUBLICAN VISION OF THE 1790S* (1984); E. FONER, *FREE SOIL, FREE LABOR, FREE MEN: THE IDEOLOGY OF THE REPUBLICAN PARTY BEFORE THE CIVIL WAR* (1970); and G. WOOD, *THE CREATION OF THE AMERICAN REPUBLIC 1776-1787* (1969).

A. Background: *The Republican Revival*

There are many possible ways to describe the republican tradition.<sup>30</sup> For present purposes, a relatively simple picture will do. Since this Article has the pragmatic goal of exploring the possibilities for practicing and encouraging citizen self-government, this picture will emphasize the political design features of republicanism rather than its foundations in ethical philosophy. Accordingly, the polar opposite of this version of republicanism is not "liberalism" in the abstract, but interest group pluralism.<sup>31</sup>

In contrast to liberalism's negative freedom, a "freedom to be left alone . . . that implies being alone,"<sup>32</sup> republicanism offers the hope that "freedom might encompass an ability to share a vision of a good life or a good society with others."<sup>33</sup> We are thus empowered to engage in "collective, deliberate, active intervention in our fate, in what would otherwise be the by-product of private decisions."<sup>34</sup> Where liberalism embraces or at least accepts the politics of self-interest, republicanism expects citizens to place the general

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<sup>30</sup> As Professor Michelman observes, "Republicanism is not a well-defined historical doctrine. As a 'tradition' in political thought, it figures less as canon than ethos, less as blueprint than as conceptual grid, less as settled institutional fact than as semantic field for normative debate and constructive imagination." Michelman, *supra* note 19, at 17 (footnote omitted). Within the republican tradition, it is easy to find strongly held views that few would find attractive today; for example, the ardent militarism of Machiavelli and the profoundly elitist view of the human *telos* suggested by Hannah Arendt. See H. ARENDT, *supra* note 16, at 121; N. MACHIAVELLI, *The Discourses*, in *THE PRINCE AND THE DISCOURSES* 443-62 (1950).

<sup>31</sup> For a description of interest group pluralism, see *supra* notes 5-8 and accompanying text.

<sup>32</sup> HABITS OF THE HEART, *supra* note 29, at 23. The authors give this example of a person who lives by the principle of negative freedom:

Thus Margaret Oldham, for example, sets great store on becoming an autonomous person, responsible for her own life, and she recognizes that other people, like herself, are free to have their own values and to lead their lives the way they choose. But then, by the same token, if she doesn't like what they do or the way they live, her only right is the right to walk away. In some sense, for her, freedom to be left alone is a freedom that implies being alone.

*Id.*

<sup>33</sup> *Id.* at 24.

<sup>34</sup> Pitkin, *Justice: On Relating Private and Public*, 9 POL. THEORY 327, 344 (1981); see also M. SANDEL, *supra* note 29, at 150-51. Thus, the carriers of the republican tradition today are civic volunteers and social movement activists. See HABITS OF THE HEART, *supra* note 29, at 51. In Rousseau's classic statement of positive freedom, moral liberty "alone makes [man] truly master of himself; for the mere impulse of appetite is slavery, while obedience to a law which *we* prescribe to *ourselves* is liberty." J. ROUSSEAU, *supra* note 17, at 19 (emphasis added).

good ahead of personal gratification.<sup>35</sup> To make possible this "civic virtue," republicanism rejects liberalism's procedural vision of justice, which tolerates wide disparities in wealth, and insists that if citizens are in fact created equal, then they must enjoy a rough measure of actual equality in the distribution of wealth.<sup>36</sup>

The new republicans are not true republicans in the classical sense. While emphasizing the importance of civic virtue and political participation, they reject the ancient view that the political life is *the* way of life: "Modern men and women know too well the dangers of a unitary politics that lays claim to all the human soul and affects to express man's 'higher nature.'"<sup>37</sup> Their claim is the more limited one that our society is out of balance; it privileges autonomy (read isolation) over community, acquisitiveness over civic virtue, and instrumental rationality (exemplified by bureaucracy and market) over moral choice (exemplified by public moral discourse). The new republicans would reverse these priorities, rather than root out all traces of liberalism.<sup>38</sup>

### B. *Direct Popular Participation and the Problem of Size*

Direct citizen participation plays a central role in the republican vision. Without it, the benefits of positive freedom cannot be realized:

<sup>35</sup> See Michelman, *supra* note 19, at 19; Sunstein, *Interest Groups*, *supra* note 20, at 31. Rousseau warned that as "soon as public service ceases to be the chief business of the citizens," the fall of the State is not far off. J. ROUSSEAU, *supra* note 17, at 93.

<sup>36</sup> See J. ROUSSEAU, *A Discourse on Political Economy*, in *THE SOCIAL CONTRACT AND DISCOURSES*, *supra* note 17, at 306-07; see also *HABITS OF THE HEART*, *supra* note 29, at 25-26; Michelman, *supra* note 19, at 19-20.

<sup>37</sup> B. BARBER, *supra* note 29, at 118. Thus, Michelman holds that republicanism loses its attractiveness as an alternative to pluralism if it depends on the assumption of a human *telos*, the realization of which takes precedence over the individual's freedom to choose her own good life. See Michelman, *supra* note 19, at 22.

<sup>38</sup> The republican and liberal traditions have been intertwined since their inceptions, and there is no reason other than abstract conceptual consistency for insisting that they be surgically separated now. See, e.g., M. TUSHNET, *RED, WHITE, AND BLUE: A CRITICAL ANALYSIS OF CONSTITUTIONAL LAW* 4 n.8 (1988) (noting that although contemporary scholars have insisted that the framers world-view was either one of liberalism or republicanism, in reality, the framers "almost certainly had not sorted out the theories in the way that later authors have"); cf. Fallon, *What is Republicanism, and Is It Worth Reviving?*, 102 HARV. L. REV. 1695, 1730-31 (1989) (noting overlaps between liberalism and the new republicanism). This Article retains the liberal concept of rights, and thus falls in the camp that C. Edwin Baker calls "republican liberalism." Baker, *Republican Liberalism: Liberal Rights and Republican Politics*, 41 U. FLA. L. REV. 491, 493 (1989).

As long as politics is equated with government, and government regarded as a means for achieving private purposes and reconciling conflicting private claims in a generally acceptable manner, rightly designed representative institutions may serve its purposes very well. But if its real function is to direct our shared, public life, and its real value lies in the opportunity to share in power over and responsibility for what we jointly, as a society, are doing, then no one else can do my politics 'for' me, and representation can mean only the exclusion of most people from its benefits most of the time.<sup>39</sup>

Only through participation can individuals overcome selfish parochialism to become virtuous citizens. In the course of political deliberation, we are "forced to acknowledge the power of others and appeal to their standards," to "find or create a common language of purposes and aspirations," and thus "not merely to clothe our private outlook in public disguise, but to become aware ourselves of its public meaning."<sup>40</sup>

In a darker vein, only an active citizenry can defend itself against corruption and tyranny. Rousseau warned that citizens who fail to make public service their chief business will "end by having soldiers to enslave their country and representatives to sell it."<sup>41</sup> Benjamin Barber has updated Rousseau's warning: "Only an active politics and a democratic citizenry can prevent the transformation of relativism into nihilism or of philosophical skepticism into political impotence (the Weimar Republic comes to mind)."<sup>42</sup>

Classical republicanism assumed a polity small enough for the entire citizenry to engage in face-to-face political discussion.<sup>43</sup> Obviously, the United States is too large for a general assembly of the whole people. The response of the new republicans to this difficulty, which has haunted American republicans from the anti-federalists on, will determine republicanism's relevance and attractiveness as an alternative perspective on the Constitution.

If face-to-face debate is impossible on the national level, then where can republican dialogue take place? In their initial efforts,

<sup>39</sup> Pitkin, *Representation*, in POLITICAL INNOVATION AND CONCEPTUAL CHANGE 132, 150 (T. Ball, J. Farr & R. Hanson eds. 1989). Rousseau put the proposition more starkly: "[T]he moment a people allows itself to be represented, it is no longer free: it no longer exists." J. ROUSSEAU, *supra* note 17, at 96.

<sup>40</sup> Pitkin, *supra* note 34, at 347; see also B. BARBER, *supra* note 29, at 235-37; C. PATEMAN, *supra* note 29, at 25.

<sup>41</sup> J. ROUSSEAU, *supra* note 17, at 93; see also *infra* text accompanying notes 173-76.

<sup>42</sup> B. BARBER, *supra* note 29, at 108-09.

<sup>43</sup> See *supra* note 17.



Michelman and Sunstein found a home for republicanism in the manageably sized congressional and judicial elites, most importantly the Justices of the Supreme Court.<sup>44</sup> It will be useful to take a brief journey through Professor Michelman's two principal contributions, which graphically reveal the relationship between republican elitism and the problem of size.

### C. *The Elitist Solution*

In his Harvard *Foreword* on republicanism, Professor Michelman straightforwardly confronts both the problem of size and the problem of elitism. Direct citizen self-government might have been possible in eighteenth century Geneva, but "for citizens of the United States, national politics are not imaginably the arena of self-government in its positive, freedom-giving sense."<sup>45</sup> With some trepidation, Michelman finds a place where it does seem that republican values can be realized: the ultimately small (nine strong) and homogeneous (members of the legal elite) society of the Supreme Court.<sup>46</sup> The Court takes on as one of its "ascribed functions the modeling of active self-government that citizens find practically beyond reach. Unable as a nation to practice our own self-government (in the full, positive sense), we—or at any rate we of 'the reasoning class'—can at least identify with the judiciary's as we idealistically construct it."<sup>47</sup>

The difficulty with this approach is that self-government by any given group (or class) presents a polycentric problem; the ability of other groups to engage in self-government is inevitably affected. Michelman is not insensitive to this difficulty. He acknowledges that his approach may be "a pathology of court-fetishism,"<sup>48</sup> but offers an "optimistic" defense. Self-government is not, he points out, a zero-sum game.<sup>49</sup> Freedom for one person or group does not necessarily entail less freedom for another if freedom is conceived of as "socially situated self-direction."<sup>50</sup> So far so good; indeed, the self-governing activity of one group might well encour-

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<sup>44</sup> See Michelman, *supra* note 19, at 74-75; Sunstein, *Interest Groups*, *supra* note 20, at 69-75.

<sup>45</sup> Michelman, *supra* note 19, at 75.

<sup>46</sup> Michelman acknowledges the anti-democratic difficulty and limits his claim to revealing "optimistic possibilities." See *id.* at 74.

<sup>47</sup> *Id.* (quoting J. ELY, *supra* note 8, at 59 & n.\*\*).

<sup>48</sup> *Id.*

<sup>49</sup> See *id.* at 74-75.

<sup>50</sup> *Id.* at 75.

age similar activity by others—both by example and by stimulating intergroup dialogue.

The Supreme Court is not, however, just any group; it possesses tremendous power to frustrate self-governing activity by others, most notably by overturning the outcomes of the legislative process. Here, Michelman points out—uncontroversially from a republican point of view—that we, the people, are no more present in Congress than we are in the Court, and “government fetishism is no better than court-fetishism.”<sup>51</sup> Any particular exercise of judicial review may augment or constrict our freedom: “As usual, it all depends.”<sup>52</sup>

To establish that judicial review is not inherently anti-freedom or anti-democratic is not, however, to establish that it should go so far as to provide a vicarious substitute for direct democracy. Numerous other roles are possible, for example the familiar ones of enforcing conventional morality<sup>53</sup> or tradition,<sup>54</sup> or the one proposed here: the republican process role of opening possibilities for democratic discourse.<sup>55</sup>

Michelman’s proposal rests ultimately on the claim that the Court can supply an acceptable representation of the kind of direct self-government that we would practice were our polity small and homogeneous enough to make it possible. If “we” is read to mean We the People, however, then the claim collapses. To suggest that judges, who are typically white, male, and rich,<sup>56</sup> can virtually represent the rest of us is to forget the legacy of legal realism, something that I doubt Michelman intends.

The possibility that the Court could represent self-government among the “reasoning class” may be, depending upon the definition of the class, more plausible. But the problem of definition requires a straightforward trade-off of democracy for plausibility. If the reasoning class includes only academically trained intellectuals, for example, then the notion of Supreme Court representation is

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> See, e.g., Wellington, *Common Law Rules and Constitutional Double Standards: Some Notes on Adjudication*, 83 YALE L.J. 221, 310-11 (1973) (suggesting that conventional morality should dictate the proper bounds of judicial review).

<sup>54</sup> See, e.g., *Wolf v. Colorado*, 338 U.S. 25, 28-32 (1949) (Frankfurter, J.) (relying on the historical treatment of evidence in refusing to apply the federal exclusionary rule to the states).

<sup>55</sup> See *infra* notes 276-375 and accompanying text.

<sup>56</sup> See A. BLAUSTEIN & R. MERSKY, *THE FIRST ONE HUNDRED JUSTICES* 55-56, 60 (1978); Brest, *Who Decides?*, 58 S. CAL. L. REV. 661, 667-69 (1985).

plausible, but profoundly undemocratic. If, on the other hand, the reasoning class extends to all members of society who are engaged in serious moral choice and dialogue—including, for example, religious fundamentalists, feminists, union militants, and black activists—then Supreme Court representation would be more fictional than virtual.

In the end, despite his aversion to elitism, Michelman chose an elitist solution. One is left with the question of why, given that Michelman drew the term “reasoning class” from John Ely’s book, did he not also address the problem to which Ely was referring: “The danger that upper-middle-class judges and commentators will find upper-middle-class values fundamental.”<sup>57</sup>

#### D. *Back to Square One*

In his more recent contribution, *Law’s Republic*, Michelman moves decisively away from the elitist implications of the *Foreword* but only at the cost of abandoning his solution to the size dilemma. In *Law’s Republic*, the primary impetus for transformative republican lawmaking comes not from empowered elites at the center of society, but from hitherto subjugated groups at the margins.<sup>58</sup> For example, the “emergent social presence and self-emancipatory activity of Black Americans” played “the primary and crucial role” in shaping the Warren Court’s new approach toward the equal protection clause.<sup>59</sup> Thus, the task for legal thinkers is to bring “the hitherto absent voices of emergently self-conscious social groups” to “legal-doctrinal presence.”<sup>60</sup>

How to do this is, of course, precisely the question made difficult by the problem of size. One way to bring in marginal voices is simply to have the Supreme Court listen to them, an approach thoughtfully articulated by Professor Martha Minow without any particular reliance on republican theory.<sup>61</sup> Michelman adds a second, process-facilitating suggestion: the Court can seek to preserve the conditions necessary to support self-governing activity by the disempowered. Thus, for example, the dissenters’ position in *Bowers v. Hardwick*<sup>62</sup> can be defended with a republican

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<sup>57</sup> J. ELY, *supra* note 8, at 59 n.\*\*.

<sup>58</sup> See Michelman, *Law’s Republic*, 97 YALE L.J. 1493, 1529 (1988).

<sup>59</sup> See *id.* at 1530.

<sup>60</sup> *Id.* at 1529.

<sup>61</sup> See Minow, *supra* note 19, at 88-89.

<sup>62</sup> 478 U.S. 186 (1986). Hardwick was charged with committing sodomy with a

process argument that, "[j]ust as property rights—rights of having and holding material resources—become, in a republican perspective, a matter of constitutive political concern as underpinning the independence and authenticity of the citizen's contribution to the collective determinations of public life, so is it with the privacies of personal refuge and intimacy."<sup>63</sup> In this process-enhancing role, the Court facilitates rather than displaces or represents popular participation.<sup>64</sup>

Unfortunately, this insight yields little in the way of prescription that Michelman had not already taught us long before his journey into Pocock, Pitkin, and Harrington, when he argued that the Constitution compels government to provide a "social minimum" of resources to every person so that he or she can function as a full participant in the political life of the community.<sup>65</sup> Moreover, *Law's Republic* leaves us back at square one on the problem of size.

### E. A Popular Republican Dilemma

With the publication of the Yale Symposium on the Civic Republican Tradition, the development of a republican alternative advanced to a new stage. Symposium participants, ranging from Paul Brest to Richard Epstein, pointed out the elitism in the Michelman and Sunstein articles.<sup>66</sup> Sunstein and—as we have

consenting adult in his bedroom. A five-member majority rejected Hardwick's claim that his constitutional right of privacy had been infringed. *See id.* at 190. The dissenters argued that the state had violated Hardwick's "right to be let alone." *Id.* at 199 (Blackmun, J., dissenting).

<sup>63</sup> Michelman, *supra* note 58, at 1535 (footnotes omitted).

<sup>64</sup> For a more skeptical view of Michelman's attempt to give the Court a process-enhancing role, see Abrams, *Law's Republicanism*, 97 YALE L.J. 1591, 1597-98 (1988).

<sup>65</sup> See Michelman, *Foreword: On Protecting the Poor Through the Fourteenth Amendment*, 83 HARV. L. REV. 7, 9-16 (1969).

<sup>66</sup> See Abrams, *supra* note 64, at 1603 ("In their distinctive ways, both Michelman and Sunstein redirect our attention to the activities of a narrower citizenry: members of the judiciary."); Bell & Bansal, *The Republican Revival and Racial Politics*, 97 YALE L.J. 1609, 1620 (1988) ("[T]he current interest in civic republicanism may be a passing fashion for those with the luxury to revel in the life of the mind . . ."); Brest, *Further Beyond the Republican Revival: Toward Radical Republicanism*, 97 YALE L.J. 1623, 1625 (1988) ("[I]t is at least ironic that much of the legal scholarship of the republican revival, rather than working to promote participation and discourse . . . is as court-centered as the pluralist scholarship from which it distinguishes itself."); Epstein, *Modern Republicanism: Or The Flight From Substance*, 97 YALE L.J. 1633, 1642 (1988) ("The cynic might well say that both Michelman and Sunstein applaud republicanism because it gives skilled academics a comparative advantage: this is the public choice explanation as to why intellectuals prefer politics to markets."); Powell, *Reviving Republicanism*, 97 YALE L.J. 1703, 1708 (1988) (suggesting that Sunstein's proposals

seen—Michelman both moved beyond their earlier court-centered suggestions, finding traces of republican self-government in, for example, local communities, religious congregations, unions, and other intermediate groups.<sup>67</sup> This new focus on direct participation by ordinary citizens moves the republican revival away from the elitist tradition of republican thought, exemplified by *The Federalist*, and toward the popular republican tradition, exemplified by Rousseau and Thomas Jefferson.<sup>68</sup>

In rejecting elitism, however, the new republicans have been thrown back on the horns of the size dilemma. While small groups undoubtedly provide a manageably sized forum for direct participation, the problem of self-government at the national level remains. How are disempowered groups to engage in nationwide dialogue and lawmaking?

One group of scholars, tagged by one of its number as “normative pluralists,” has suggested an alternative: forget nationwide self-government and rely on self-regulating interactions among autonomous self-governing groups.<sup>69</sup> These thinkers have made an undeniable contribution in disclosing and explaining the importance of group self-government to strong democracy.<sup>70</sup> To the extent that their emphasis on autonomous groups *excludes* nationwide self-government, however, they fall prey to the centrifugal vices of

reflect assumptions that “contradict a belief in participatory or ‘strong’ democracy: a distrust in at least the wisdom of the citizen body generally, and a corresponding confidence that a select and autonomous body of representatives are more likely to make intelligent and virtuous decisions for the public good than is the public itself.” (footnotes omitted)).

<sup>67</sup> See Michelman, *supra* note 58, at 1531; Sunstein, *Beyond the Republican Revival*, 97 YALE L.J. 1539, 1578 (1988).

<sup>68</sup> On the elitist republicanism of *The Federalist*, see Sunstein, *Interest Groups*, *supra* note 20, at 38-45; see also *infra* text accompanying notes 252-55. For some characteristic Rousseauian statements on the necessity for popular participation, see *supra* notes 34-35; text accompanying note 41. For more on this aspect of Rousseau's thought, see C. PATEMAN, *supra* note 29, at 22-27. A thorough and thought-provoking summary of Jefferson's views may be found in R. MATTHEWS, *THE RADICAL POLITICS OF THOMAS JEFFERSON: A REVISIONIST VIEW* 77-95 (1984).

<sup>69</sup> See Cover, *Foreword: Nomos and Narrative*, 97 HARV. L. REV. 4, 46-53 (1983); Sullivan, *Rainbow Republicanism*, 97 YALE L.J. 1713, 1716-21 (1988).

<sup>70</sup> For essays that make this contribution while leaving the possibility of nationwide self-government ambiguous, see, e.g., Baker, *The Process of Change and the Liberty Theory of the First Amendment*, 55 S. CAL. L. REV. 293 (1981); Garet, *Communality and Existence: The Rights of Groups*, 56 S. CAL. L. REV. 1001 (1983); Soifer, *Toward a Generalized Notion of the Right to Form or Join an Association: An Essay for Tom Emerson*, 38 CASE W.L. REV. 641 (1988).

anarchism.<sup>71</sup> We cannot so easily escape the dilemma of strong democracy at the national level.

## II. REPUBLICAN MOMENTS

The search for alternatives to interest group politics should begin not in the realm of theory but in the political life of ordinary citizens.<sup>72</sup> In his *Storrs Lectures*, Bruce Ackerman has provided an excellent starting point.<sup>73</sup>

### A. Ackerman's Constitutional Moments

Professor Ackerman is painfully aware of the difficulties facing citizens who seek to practice republican politics. An appeal to the public interest is likely to be met "with bewilderment, or worse, by friends and neighbors who fail to look beyond their parochial interests."<sup>74</sup> Most of the citizenry most of the time is simply too apathetic, ignorant of public issues, and selfish to engage in political activity.<sup>75</sup> A serious attempt to eliminate these obstacles would require a system of "coercive democracy," which would force citizens to pay attention, for example, by compelling them to spend an hour or two each day discussing public issues. Since the coercive cure is worse than the liberal pluralist disease, the normal operation of politics must be conceded to interest group representation—albeit bounded by civic-minded judicial review.<sup>76</sup>

But Ackerman extends his search for citizen self-government beyond the bounds of representative government. There, he finds a "higher lawmaking track," textually rooted in article V's provision for constitutional conventions, theoretically elaborated in *The Federalist*, and historically manifested in three constitutional moments: (1) the founding of the republic; (2) the events culminat-

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<sup>71</sup> See M. TUSHNET, *supra* note 38, at 155. Cover asserts optimistically that conflict among groups with competing normative commitments will be muted spontaneously by the competing norms themselves, which limit the situations in which open conflict is justified. See Cover, *supra* note 69, at 50.

<sup>72</sup> As Benjamin Barber has pointed out, institutions of self-government "should be realistic and workable. For all practical purposes, this means that they ought to be a product of actual political experience." B. BARBER, *supra* note 29, at 262.

<sup>73</sup> See Ackerman, *The Storrs Lectures: Discovering the Constitution*, 93 YALE L.J. 1013 (1984).

<sup>74</sup> *Id.* at 1034.

<sup>75</sup> See *id.* at 1033-34.

<sup>76</sup> See *id.* at 1028-30, 1034-35.

ing in the adoption and acceptance of the Civil War amendments; and (3) the constitutional vindication of the New Deal.<sup>77</sup>

In order to succeed on the higher track, a political movement must refuse to be bought off by short-term selfish gains obtainable on the lower track.<sup>78</sup> This requires a high level of commitment from the movement's adherents. For these citizens, the normal priority of private over public life is reversed; they become private *citizens* instead of *private* citizens. If they persevere, and if they "strike a resonant chord" among the people, "their strong appeals to the public good are no longer treated as if they were the ravings of fringe elements."<sup>79</sup> At such moments, "millions of Americans do manage, despite the countless diversions of liberal democratic society, to engage in an act of self-government with a seriousness that compares to the most outstanding constitutional achievements of the past."<sup>80</sup>

Inspiring talk. But at first glance, it seems that Professor Ackerman has come to praise republicanism only to bury it. His theory celebrates a system that has produced only three constitutional moments in two centuries, and two of those involved full-scale warfare. Ackerman's three moments are not, however, intended as a comprehensive list of popular republican periods. He set out to develop a theory of judicial review, not of direct popular power. In pursuit of that agenda, he sought only periods of citizen involvement so intense, widespread, and coherent that they could plausibly be said to provide the Court with a mandate to overturn legislative enactments.<sup>81</sup> This Article, which seeks to explore the role of direct popular power in general, requires a broader search.

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<sup>77</sup> See *id.* at 1051-52, 1058.

<sup>78</sup> See *id.* at 1040-41.

<sup>79</sup> *Id.* at 1042.

<sup>80</sup> *Id.* at 1043.

<sup>81</sup> What distinguishes Ackerman's three constitutional moments from other participatory periods is the relative coherence of their outcomes at the level of constitutional lawmaking. The first two produced constitutional texts, and the third, the New Deal, produced a focused showdown between the popular movement for economic regulation and the Supreme Court's free market activism. Thus, it is not true that—as Mark Tushnet has charged—there is no logic behind Ackerman's three moments other than that he approved of their results. See M. TUSHNET, *supra* note 38, at 25.

B. *Public Purpose and Creedal Passion*

Historians and political scientists have long recognized and pondered over the fact that American politics seems to alternate between periods characterized by public action, idealism, and reform and periods of private interest, materialism, and retrenchment.<sup>82</sup> Each period helps to generate its own demise. A prolonged private period spawns orgies of corruption and extremes of wealth and poverty that, sooner or later, ignite passionate movements for reform. Public periods inevitably burn themselves out; most people eventually become exhausted with politics and return to family and private pursuits.<sup>83</sup>

Seven periods are often mentioned as public periods: the Revolutionary era, the Jeffersonian upsurge, the Jacksonian period, the Civil War and Reconstruction, the Populist era, the New Deal, and the 1960s.<sup>84</sup> Most produced what V.O. Key labelled "Critical Elections"—elections that reflect basic shifts in the nationwide alignment of political forces.<sup>85</sup>

Samuel P. Huntington has described the two modes of politics in detail. He contrasts interest group pluralism, which "accounts for most of American politics most of the time," with a distinct, participatory mode—"creedal politics"—which supplements and at times supplants interest group bargaining.<sup>86</sup> In creedal politics, the republican ideals of direct participation and socially-situated moral discourse prevail over their liberal counterparts. Creedal politics tends to be "idealistic rather than materialistic, reform-minded rather than status-quo oriented, and formulated in terms of

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<sup>82</sup> See A. SCHLESINGER, JR., *THE CYCLES OF AMERICAN HISTORY* 24-26 (1986); A. SCHLESINGER, SR., *PATHS TO THE PRESENT* 80-84 (1949). Albert O. Hirschman made the point more generally for western capitalist countries. See A. HIRSCHMAN, *SHIFTING INVOLVEMENTS: PRIVATE INTEREST AND PUBLIC ACTION* 3-8 (1982). For a recent statement, see K. PHILLIPS, *THE POLITICS OF RICH AND POOR* xx (1990).

<sup>83</sup> See A. HIRSCHMAN, *supra* note 82, at 92-102; A. SCHLESINGER, JR., *supra* note 82, at 28.

<sup>84</sup> Arthur Schlesinger, Jr. embraces all seven, characterizing swings between private and public periods as generation-driven; others focus on varying subsets, with different theories to explain the shifts between periods. See A. SCHLESINGER, JR., *supra* note 82, at 23-25, 31-34.

<sup>85</sup> See Key, *A Theory of Critical Elections*, 17 J. POL. 3, 16 (1955). Key's observations served as the starting point for Walter Dean Burnham's influential theory of critical elections. See W. BURNHAM, *CRITICAL ELECTIONS AND THE MAINSPRINGS OF AMERICAN POLITICS* (1970).

<sup>86</sup> See S. HUNTINGTON, *AMERICAN POLITICS: THE PROMISE OF DISHARMONY* 105 (1981).



right and wrong rather than more or less.”<sup>87</sup> Practitioners of creedal politics appeal to deeply held American values, eschewing the politics of self-interest. In contrast to liberal pluralism’s emphasis on party, electoral, and interest group politics, creedal politics are characterized by protest, exposure, and reform propelled by “passionate drives to expose evil, to protest evil, and to reform evil.”<sup>88</sup>

Huntington identifies four “creedal passion periods” when this form of politics predominated: (1) the Revolutionary era of the 1760s and 1770s; (2) the Jacksonian age of the 1820s and 1830s; (3) the Populist-Progressive decades of the 1890s and 1900s; and (4) the period of social upheaval sparked by the civil rights, anti-war, and women’s rights movements in the 1960s and early 1970s.<sup>89</sup> During such periods, political ideas and ideals are taken seriously throughout society.<sup>90</sup> Political participation is widespread and intense. Public-spirited voluntary associations, “the peculiar American contribution to achieving the common good,” displace political parties and representative government as the preferred organizational form for political action.<sup>91</sup> Although creedal movements invariably fall far short of their goals, they have forced major structural reforms, for example the introduction of universal white male suffrage during the Jacksonian era, the first regulatory commissions and antitrust laws during the Populist-Progressive era, and the dismantling of legal segregation in the South during the 1960s.<sup>92</sup>

Huntington claims that his construct captures the main historical periods during which the American people practiced an alternative form of politics to interest group pluralism. His pursuit of a narrower agenda has, however, led him to omit highly significant periods of direct citizen participation. Of particular importance is his omission of the New Deal.<sup>93</sup>

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<sup>87</sup> *Id.*

<sup>88</sup> *Id.* at 180.

<sup>89</sup> *See id.* at 4, 85.

<sup>90</sup> *See id.* at 93-97.

<sup>91</sup> *Id.* at 97-99.

<sup>92</sup> *See id.* at 116-17, 198.

<sup>93</sup> Huntington also omits the era of Civil War and Reconstruction, unfortunately without explanation. This omission is, however, less of a problem because the occurrence of full-scale warfare mutes the significance of direct citizen participation. Moreover, Huntington implies in an aside that he views the abolitionist movement as a creedal movement. *See id.* at 98.

Huntington excludes the New Deal because, in his view, it focused on economic rather than political problems, substituted pragmatism for the "moralism and Puritanism" characteristic of other creedal periods, expanded rather than cleansed or democratized government, and mobilized social movements along horizontal class lines rather than the "more vertical cleavage characteristic of creedal passion periods."<sup>94</sup>

None of these distinctions are germane to our search for experiences of citizen self-government. Huntington does not, and could not, deny that the New Deal embodied all of the features of his creedal periods that are important here: widespread and intense political participation, political discourse centering on principles rather than narrow self-interest, serious consideration of far-reaching change, and the overshadowing of representative government by voluntary associations and social protest.

Indeed, a strong case can be made that Huntington was wrong to exclude the New Deal even on his own terms. His characterization of the New Deal as economic, pragmatic, and lacking in purifying or democratizing impulses fails to take account of the period's climactic conflict. By the time of the New Deal, the labor movement and its allies had been fighting for decades to implement economic reform, scoring numerous legislative victories. Most of these successes were nullified by courts.<sup>95</sup> The New Deal period saw the elimination of the unelected judiciary as a barrier to popular legislation, the transfer of enforcement power from what were perceived to be anti-democratic judges to public-minded administrators,<sup>96</sup> and the extension of democratic government to the market realm.

Of course, in the depths of the Great Depression, the main concern of policymakers was economic recovery. But the public debate was heavily influenced by popular movements voicing the language of equality, justice, and fundamental rights. In the period leading up to the New Deal, "[e]veryone from Woodrow Wilson to Big Bill Haywood acknowledged that the 'labor question' was not merely the supreme economic question but the constitutive moral, political, and social dilemma of the new industrial order."<sup>97</sup>

<sup>94</sup> *Id.* at 90-91.

<sup>95</sup> See Forbath, *The Shaping of the American Labor Movement*, 102 HARV. L. REV. 1109, 1132-48, 1237-48 (1989).

<sup>96</sup> See J. LANDIS, *THE ADMINISTRATIVE PROCESS* 33-34 (1938).

<sup>97</sup> Fraser, *The Labor Question*, in *THE RISE AND FALL OF THE NEW DEAL ORDER* 55,

Consider the Wagner Act, a centerpiece of the New Deal order. While the lawyers who drafted the law saw it as a Keynesian recovery measure,<sup>98</sup> its political supporters also viewed it as a democratic reform, the replacement of industrial feudalism and slavery by freedom of self-organization and God-given rights.<sup>99</sup> The law was enacted partly in response to a massive wave of protest marches, strikes, job actions, and other protests.<sup>100</sup> In 1937, *Fortune Magazine* provided what may be the best brief summary of the relationship between economic pressures, popular upsurge, and the Wagner Act:

A labor movement fighting merely for better wages might or might not be a "movement" in the profound sense: it might be a kind of guerrilla warfare, indicating unrest but without historical direction. On the other hand, when men strike for union recognition they are striking for collective bargaining . . . . The fact that half of the 1936 strikes were fought for [this] principle, with the trend continuing into the stormy spring and summer of 1937, is of such significance that those who follow labor closely are inclined to doubt the comfortable theory . . . to the effect that the current wave of strikes is just a normal post-depression phenomenon. . . . Washington has strengthened labor's position, not just

55 (S. Fraser & G. Gerstle eds. 1989).

<sup>98</sup> See Casebeer, *Holder of the Pen: An Interview with Leon Keyserling on Drafting the Wagner Act*, 42 U. MIAMI L. REV. 285, 295-96 (1987).

<sup>99</sup> See 78 CONG. REC. 12,044 (1934) (Sen. Wagner). Representative William Connery, who introduced the Wagner Act in the House, proclaimed that the right to strike "is not a right that comes from Congress, but is a divine right which comes from the Almighty God." 79 CONG. REC. 9730 (1935).

<sup>100</sup> See F. PIVEN & R. CLOWARD, POOR PEOPLE'S MOVEMENTS 129-33 (1977); Goldfield, *Worker Insurgency, Radical Organization, and New Deal Labor Legislation*, 83 AM. POL. SCI. REV. 1257, 1270-73 (1989). As always, the attribution of social causation is open to challenge. The main evidence offered to disprove a causal link between worker protest and the Wagner Act is the decline in strike activity between the 1934 strike wave, which included several successful general strikes, and the enactment of the Wagner Act in 1935. See Skocpol, *Political Response to Capitalist Crisis: Neo-Marxist Theories of the State and the Case of the New Deal*, 10 POL. & SOC'Y 155, 187-89 (1980). But as Professor Hyde points out,

it seems highly reductionist to suppose that month-by-month levels of unrest would alone, or even importantly, determine the timing of the law-making process. Legislation could still be said to respond to unrest, particularly if some significant unrest in the near future appeared likely throughout the period, as was true in 1935.

Hyde, *A Theory of Labor Legislation*, 38 BUFFALO L. REV. 383, 437 (1990). Other arguments are discussed and refuted in Goldfield, *supra*, at 1259-76.

for the hell of it, but in response to forces that the depression stimulated and revitalized.<sup>101</sup>

Huntington's final distinction is puzzling. He contrasts the class-based cleavages of the New Deal with the "vertical" (i.e., cross-class) cleavages of creedal passion periods.<sup>102</sup> It turns out, however, that the creedal movements were dominated by "middle-class" reformers.<sup>103</sup> As with most successful reform movements, these leaders found support outside their own class. It is hard to see why this made Huntington's middle-class dominated creedal movements qualitatively more "vertical" than the New Deal's working-class movements, which found numerous allies among the middle classes and, according to some, among the upper classes.<sup>104</sup> It seems that Huntington either rejects the possibility of working class people engaging in moral politics, or has chosen, for some reason, to exclude such movements from his construct.

In short, Huntington's creedal construct is too narrow for present purposes. We are concerned not with the "Puritan" content of reform demands or with middle class leadership, but with the popular republican character of political life among all moral viewpoints and social classes.<sup>105</sup> Hence, instead of "public periods" or "creedal passion periods," the term "republican moments" best identifies the phenomenon under study here.

### C. *Republican Moments*

Republican moments are not, of course, republican in the strict sense. At no time did direct citizen self-government entirely displace the interest group process. Nor was the classical ideal of the deliberative republic implemented in any recognizable form. These periods were, however, republican in the same sense that the republican revival is republican.<sup>106</sup> The everyday liberal priorities

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<sup>101</sup> *The Industrial War*, FORTUNE, Nov. 1937, at 106, 156.

<sup>102</sup> See S. HUNTINGTON, *supra* note 86, at 91.

<sup>103</sup> See *id.* at 106, 181.

<sup>104</sup> See, e.g., Ferguson, *Industrial Conflict and the Coming of the New Deal: The Triumph of Multinational Liberalism in America*, in THE RISE AND FALL OF THE NEW DEAL ORDER, *supra* note 97, at 3, 19-24 (discussing Franklin Roosevelt's political alliances with big business during the New Deal).

<sup>105</sup> Although the focus here is on groups that are disempowered in interest group bargaining, it seems that even business groups—the perennial winners in interest group politics—practice a more republican form of politics during periods of heightened struggle. See Martin, *Constructed Interests and Elite Social Movements: Tax Reform in 1986*, at 4-17 (1990) (unpublished paper on file with the author).

<sup>106</sup> On the divergence of the republican revival from classical republicanism, see

of autonomy over community, acquisitiveness over civic virtue, and instrumental rationality over moral choice were reversed, albeit only partially and temporarily.

Republican moments have five defining features. The first three track the republican-liberal distinction: (1) large numbers of Americans engage in serious political discourse; (2) their arguments are couched primarily in moral rather than pecuniary terms and appeal to the common good rather than private interest; and (3) the subjects of debate include fundamental aspects of the social, political, or economic order.

The last two track the distinction between direct popular power and representative politics-as-normal: (4) representative politics are overshadowed by extra-institutional forms of citizen participation such as popular assemblies, militant protest, and civil disobedience; and (5) social movements and voluntary associations displace interest groups and political parties as the leading forms of political organization.<sup>107</sup>

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*supra* notes 37-38 and accompanying text.

<sup>107</sup> The historical distinction between republican moments and liberal politics-as-normal parallels the sociological distinction between social movements and interest groups. Social movements typically employ extra-institutional direct action tactics, while interest groups rely primarily on routinized lobbying relationships with public officials. See D. MCADAM, *POLITICAL PROCESS AND THE DEVELOPMENT OF BLACK INSURGENCY 1930-1970*, at 24-25 (1982); Eder, *The "New Social Movements": Moral Crusades, Political Pressure Groups, or Social Movements?*, 52 SOC. RES. 869, 884-85 (1985).

Social movements tend to be informally organized and participatory; interest groups are usually bureaucratized and hierarchical. See McCarthy & Zald, *Resource Mobilization and Social Movements: A Partial Theory*, in *SOCIAL MOVEMENTS IN AN ORGANIZATIONAL SOCIETY* 15, 20-25 (M. Zald & J. McCarthy eds. 1987). While social movements seek to implement moral principles, interest groups simply demand more for their members. See Eder, *supra*, at 885. Social movements advocate basic change; interest groups focus on incremental gains. See, e.g., R. HEBERLE, *SOCIAL MOVEMENTS* 9 (1951) ("A pressure group is distinguished from a genuine social movement partly by the limitedness of its goal—it does not aim at a general change in the social order"); C. KING, *SOCIAL MOVEMENTS IN THE UNITED STATES* 27 (1956) (stating that a social movement is "a group venture extending beyond a local community or a single event and involving a systematic effort to inaugurate changes in thought, behavior, and social relationships"); K. LANG & G. LANG, *COLLECTIVE DYNAMICS* 490 (1961) (explaining that social movements pursue "an objective that affects and shapes the social order in some fundamental aspect"); Blumer, *Collective Behavior*, in *PRINCIPLES OF SOCIOLOGY* 167, 169 (A. Lee ed. 1951) (describing social movements as "collective enterprises to establish a new order of life").

The distinction is not, of course, rigid over time. Social movements are often institutionalized into interest groups (for example, the late 19th century labor movement produced the American Federation of Labor) and, conversely, new social movements may arise within established interest groups (for example, the rise of the

The construct of republican moments is, of course, an ideal type—a distillation of characteristics that are rarely, if ever, observable in pure form in social practice. Three periods approach the ideal type very closely: the Revolutionary era, the New Deal, and the 1960s.<sup>108</sup> Four others are close enough to warrant the label: the Jeffersonian upsurge, the Age of Jackson, the period of Civil War and Reconstruction, and the Populist era.<sup>109</sup>

Thus far, I have focused exclusively on nationwide, multi-issue republican moments. Even when national political life is dominated by interest group bargaining, however, there is a constant simmering of popular agitation. Out of this background of low-level activity, democratic upsurges may bubble up and displace politics-as-usual at the state or local level as happened, for example, in North Dakota during the Non-Partisan League's reform campaigns of 1919-1920 or in Rhode Island during the Dorr Rebellion. Alternatively, the entire nation may experience popular republican politics on a single issue, as in the struggle for women's suffrage, and the current debate over abortion. Full-scale republican moments typically emerge out of such localized or single-issue mobilizations.<sup>110</sup>

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industrial union movement within the AFL).

<sup>108</sup> On the Revolutionary era, see G. WOOD, *supra* note 29, at 3-7, 319-28 (describing the period as one of intense and widespread debate over fundamentals, with organs of direct popular power often displacing representative institutions). On the New Deal, see *supra* text accompanying notes 93-101. For a depiction of the 1960s as embodying all of the elements of republican moments, see S. HUNTINGTON, *supra* note 86, at 167-220.

<sup>109</sup> For depictions of these periods as times of intense public involvement, see L. BANNING, *THE JEFFERSONIAN PERSUASION* (1978); E. FONER, *RECONSTRUCTION: AMERICA'S UNFINISHED REVOLUTION 1863-1877*, at 60-68, 100-23, 278-79, 281-91, 307-33 (1988); L. GOODWYN, *DEMOCRATIC PROMISE: THE POPULIST MOVEMENT IN AMERICA* 523-55 (1976); R. REMINI, *THE REVOLUTIONARY AGE OF ANDREW JACKSON* 147-51 (1976). I consider the Jeffersonian and Jacksonian moments to be less clear examples because party organization and electoral campaigning had not yet been coopted as instruments of interest-group politics-as-normal, and thus were available for use by reformers without the necessity of first building a movement through extra-electoral means. The operation of popular republican politics during the era of Civil War and Reconstruction was overshadowed by the politics of war and occupation. The populist moment was, in a sense, a failed republican moment. Although the labor and populist movements attempted to practice popular republican politics, their efforts were truncated when the major strikes of the era were crushed by military force.

<sup>110</sup> For example, the Revolutionary movement grew out of single-issue campaigns against British taxation schemes. The populist movement grew out of local farmers' alliances. The civil rights movement built on boycotts and protests that were initiated at the local level.

The resulting picture shows the American political order not as a delicately balanced machine or a harmonious body politic, but as a competition between rival modes of politics, with republican moments punctuating the operation of politics-as-normal at all levels.

#### D. *Popular Republican Pathologies?*

In response to earlier drafts of this Article, many readers objected that I must have searched for instances of popular participation through rose-colored glasses. Queried one: "I remain uncertain about why the KKK, the Red Scare, McCarthyism, Reaganism, etc. are not also 'moments'—and why exclude those mobs who tarred and feathered Wobblies, lynched blacks, smashed those opposed to World War I, and are blockading abortion clinics today?"<sup>111</sup>

One of these examples—Reaganism—bears no relation to a republican moment. The so-called "Reagan revolution" thrived on political apathy. The principal form of citizen involvement was voting, and even the rate of voter participation was down from the 1960s and 1970s, especially among groups that are relatively disempowered in interest group bargaining.<sup>112</sup> None of the defining characteristics of a republican moment was present.

The remaining examples all exhibit at least some features of republican moments. Most, however, depart decisively from the model. Republican moments are defined by widespread *participation* in serious political discourse. Many of the questioner's examples are characterized by the systematic *suppression* of discourse. Thus, for example, the Reconstruction-era Klan rode to expel Republican leaders and prevent African-Americans from voting, goals which were achieved with spectacular success in many areas of the South.<sup>113</sup> The Red Scare of 1919-1920 involved an attempt to silence radicals and the militant wing of the labor

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<sup>111</sup> I am indebted to Aviam Soifer for asking this question so forcefully that I felt compelled to attempt an answer.

<sup>112</sup> See F. PIVEN & R. CLOWARD, *WHY AMERICANS DON'T VOTE* 160-62 (1988).

<sup>113</sup> As described by David Chalmers, the main function of night riding was "to destroy the basis of Negro political effectiveness by driving out its leaders, white and black." D. CHALMERS, *HOODED AMERICANISM: THE HISTORY OF THE KU KLUX KLAN* 14 (1987). In some areas, the Klan's tactics of torture, murder, and violent intimidation virtually eliminated the Republican vote. See *id.* at 15-16; see also E. FONER, *supra* note 109, at 425-26 (observing that, in effect, "the klan was a military force serving the interests of the Democratic party").

movement, both by direct violence and by government repression.<sup>114</sup> McCarthyism was a similar, albeit less spectacular, phenomenon.

Repression and violence cannot, of course, be entirely avoided when political passions run high, but these periods are distinguished by the extent to which repression and intimidation dominated the political atmosphere. Participatory politics were displaced by a politics of fear.

Lynch-mobs, anti-Wobblie vigilantes, and patriotic enforcers are specific phenomena, not "moments." Although such groups may be active during republican moments, they are suppressing rather than practicing popular republican politics.

What about the "Pro-life" movement? There is an obvious factual distinction along right versus left political lines.<sup>115</sup> This distinction is, however, radically inconsistent with the core notion of republican moments. The focus here is on the democratic quality of the political process, not its substantive outcomes.<sup>116</sup> The current public debate over abortion meets all the criteria of a

<sup>114</sup> When socialists attempted to hold a nationwide series of celebrations on May Day in 1919, "[w]herever there were celebrations, there were also violent attacks on the Socialists." AMERICAN VIOLENCE: A DOCUMENTARY HISTORY 351 (R. Hofstadter & M. Wallace eds. 1970). A mob in Weirton, West Virginia forced 118 striking immigrants to kiss the American flag. See M. LEVIN, POLITICAL HYSTERIA IN AMERICA 28 (1971). These incidents were typical of a wide-ranging outburst of anti-striker and anti-radical violence. See R. MURRAY, RED SCARE: A STUDY OF NATIONAL HYSTERIA, 1919-1920, at 30, 180-89 (1955). The most famous instance of government repression occurred on the night of January 2, 1920, when federal officers rounded up more than 4,000 alleged radicals in 23 states. A blue-ribbon group of twelve lawyers including Roscoe Pound, Felix Frankfurter, and Zachariah Chaffee subsequently issued a report condemning the raids for gross due process violations. See M. LEVIN, *supra*, at 57-58.

<sup>115</sup> I am using the terms "right" and "left" as follows: right movements tend to be protective of established groups and elites, while left movements tend to advance the claims of hitherto excluded or disempowered groups.

<sup>116</sup> By invoking the substance-process distinction, I do not mean to claim that the construct is substantively neutral. There simply is no such thing as a substantively neutral process. See L. TRIBE, CONSTITUTIONAL CHOICES 28 (1985); Parker, *supra* note 9, at 236. The idea of republican moments embodies a left bias because it emphasizes widespread participation and extra-institutional forms of popular power. During republican moments, the out-groups tend to be more effective politically than during periods of politics-as-normal. Nevertheless, the defining characteristics are all process-based. It is quite possible for a conservative to recognize that rights of protest are likely to strengthen her political opponents, and yet to support those rights as essential to democracy. Conversely (and perhaps more often in practice) liberals may understand that their constituents benefit from rights of protest and yet oppose such rights in practice because they would rather resolve issues in the more peaceful and controllable context of elite bargaining.



republican moment. Militant anti-abortion protesters have forced the issue to the top of the legislative agenda in many states. Pro-choice activists have responded with mass demonstrations and lobbying campaigns. Politicians find themselves under intense public scrutiny on the issue. Whatever the ultimate outcome, large numbers of Americans have been drawn into a passionate, nationwide debate over fundamental moral principles.

### III. REPUBLICAN MOMENTS AS A PARTIAL ANTIDOTE TO INTEREST GROUP POLITICS

We have seen that social movements use direct power to bring on republican moments, and that republican moments tilt the polity toward the republican values of participation, virtue, and positive freedom. But is a little republicanism necessarily a good thing? After all, it was only a few decades ago that social movements were widely regarded as divisive nuisances, and their leaders as "agitators, rabble-rousers, or maladjusted personalities."<sup>117</sup>

A thorough empirical analysis of the consequences of republican moments is beyond the scope of this Article, but a canvass of the literature supports a strong hypothesis that republican moments provide correctives, albeit temporary and partial, to the main flaws of interest group pluralism. Although these flaws have been recognized and critiqued from a wide range of theoretical perspectives, I have made a special effort to address the public choice versions because of their enormous influence during the past decade.

#### A. *From Narrow Self-Interest to Public Virtue*

According to public choice theory, it would be lunacy for citizens to prefer public participation over private pursuits. Even voting, the least demanding form of political participation, may be irrational. Since the incremental benefit gained by a voter is likely to be less than the cost of obtaining the information necessary to

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<sup>117</sup> R. HEBERLE, *supra* note 107, at 417. Heberle criticizes this view as "partisan abuse of psychopathological categories." *Id.* Perhaps the most famous depiction of social movements as pathological phenomena is found in E. HOFFER, *THE TRUE BELIEVER* (1951). More recently social scientists have tended to acknowledge that social movements can perform salutary functions in promoting change and rectifying power imbalances. See Walker & Mendlovitz, *Peace, Politics and Contemporary Social Movements*, in *TOWARDS A JUST WORLD PEACE: PERSPECTIVES FROM SOCIAL MOVEMENTS* 3, 10-11 (S. Mendlovitz & R. Walker eds. 1987).

make an intelligent choice, the typical citizen is "rationally ignorant" about public affairs.<sup>118</sup> She will make the effort to overcome ignorance only if offered selective incentives to do so. This theory, however, is accurate only when isolated individuals stand face-to-face with the institutions of representative politics-as-usual.

Direct popular power alters the equation in two ways. First, it gives ordinary citizens the experience of engaging in effective collective action. In the early stages of a social movement, commitment and solidarity are forged in local struggles for limited objectives. For example, colonial mobs forced royal tax officials to resign; abolitionists helped slaves escape to Canada; industrial workers struck for union recognition; and African-Americans boycotted until white employers broke the color barrier. In local settings, individuals learn to see themselves not as the anonymous, isolated statistics of the public choice model, but as important members of an effective and empowered group. They may thus become what a recent empirical study described as "calculating Kantians" who are "willing to do their duty if enough others are doing the same."<sup>119</sup>

As a social movement gains momentum, its adherents may cease to see political action as a cost. Where the contrast between individual despair and collective empowerment is especially sharp, as during the Montgomery bus boycott of 1955-56, individuals embrace collective action as a "liberating passion rather than a distasteful chore."<sup>120</sup> The free-rider problem dissolves because the experience of self-government itself becomes a source of personal satisfaction. Thus, at some point, "the benefit of collective action for an individual is not the difference between the hoped-for

<sup>118</sup> See M. HAYES, *LOBBYISTS AND LEGISLATORS: A THEORY OF POLITICAL MARKETS* 69-70 (1981); M. OLSON, *supra* note 15, at 26. Olson explains that the rational voter will weigh the costs of obtaining information against the benefit she will receive from a correct choice multiplied by the probability that her vote will be decisive to the outcome. Since the likelihood that an election will be decided by one vote is infinitesimal, voters have little incentive to inform themselves. See *id.* at 26.

<sup>119</sup> Finkel, Muller & Opp, *Personal Influence, Collective Rationality, and Mass Political Action*, 83 AM. POL. SCI. REV. 885, 886, 900-01 (1989) (statistical study of protesters in Germany concluding that they engage in collective action because they believe either (1) that their individual participation makes a difference, or (2) that they are part of a group of people who are willing to engage in protest if enough others are willing to do the same).

<sup>120</sup> Kennedy, *Martin Luther King's Constitution: A Legal History of the Montgomery Bus Boycott*, 98 YALE L.J. 999, 1022-23 (1989) (describing the sentiment among African-Americans in Montgomery after African-Americans demonstrated surprisingly strong solidarity in the bus boycott of 1955-56).

result and the effort furnished by him or her, but the *sum* of these two magnitudes!"<sup>121</sup>

Second, the drama and disruption of direct popular power mobilize the citizenry into political discourse. When individuals must sit in a traffic jam caused by protesters, endure the glare of picketers to shop at their favorite store, do without the services of workers on strike, or see the calm of their neighborhoods disturbed by residential picketers, it becomes more difficult for them to remain focused on private pursuits. People who are not directly affected see the protests on television or read about them in newspapers. If the turmoil continues, citizens begin to pay more attention.<sup>122</sup> Although the initial reaction is usually anger against the protesters, attention eventually shifts to the underlying issues.<sup>123</sup>

Opponents of direct popular power contend that it enables small elites to force their views upon an apathetic populace.<sup>124</sup> They point to the undeniable fact that only a small fraction of the population actually participates in protest. But direct popular power rarely serves as an effective weapon for imposing one group's views on another.<sup>125</sup> Because it operates out in the open, it usually contributes not only to the mobilization of supporters, but also of opponents. Indeed, in the early stages of a movement, protest often provokes a backlash from citizens who would prefer to remain immersed in private pursuits.

In short, direct popular power is more useful in raising the pitch of political struggle than in determining its outcome. Once distracted from private pursuits, the citizenry may selectively embrace the protesters' demands, as occurred with the labor

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<sup>121</sup> A. HIRSCHMAN, *supra* note 82, at 86.

<sup>122</sup> In Olson's view, there is one major exception to the rule of rational ignorance: when information is fascinating or entertaining in itself, citizens may make the effort to acquire it for those reasons. See M. OLSON, *supra* note 15, at 26. The prime examples are sweeping statements, picturesque protests, and lively demonstrations—all hallmarks of republican moments. See *id.* at 27.

<sup>123</sup> On the role of protest in mobilizing popular constituencies, see Lipsky, *Protest as a Political Resource*, in POWER AND CHANGE IN THE UNITED STATES: EMPIRICAL FINDINGS AND THEIR IMPLICATIONS 161 (K. Dolbeare ed. 1969).

<sup>124</sup> See, e.g., Feuer, *Participatory Democracy: Lenin Updated*, in PARTICIPATORY DEMOCRACY 57, 61 (T. Cook & P. Morgan eds. 1971) (describing civil rights protests organized by the Student Nonviolent Coordinating Committee as "putschist" actions of a "small student elite").

<sup>125</sup> There is one important exception to this generalization—when a group uses direct popular power to suppress political activity by others. See *supra* text accompanying notes 113-14.

movement of the 1930s and the civil rights and anti-war movements of the 1960s, or turn against them, as appears to be happening in many states today in the struggle over abortion. The ultimate outcome, whatever it is, reflects broader and more intense public participation than interest group politics-as-usual.

### B. *Breaking the Interest Group Logjam*

One of the most powerful critiques of interest group politics, advanced from both the left and the right, points out the extreme difficulty of getting anything done or—in republican terms—of making conscious decisions about the basic direction of the country. It is commonly said that America has become “ungovernable.”<sup>126</sup> Policymakers, unwilling to consider or implement basic change, “minimax” their way toward incremental reform.<sup>127</sup> Interest groups form strong relationships with government agencies and tenaciously resist any attempt to alter the balance of forces.<sup>128</sup> It is especially difficult to change the “agenda of controversy, the list of questions which are recognized by the active participants as legitimate subjects of attention and concern.”<sup>129</sup> Logrolling, it seems, results in logjams.

While political life degenerates into stalemate, civil society continues to change. Gradually, the state grows apart from society. Government ceases to reflect either the needs or the preferences of the people.<sup>130</sup> As depicted in Figure 1, republican moments are

<sup>126</sup> M. OLSON, *supra* note 15, at 8.

<sup>127</sup> See D. BRAYBROOKE & C. LINDBLOM, *STRATEGY OF DECISION: POLICY EVALUATION AS A SOCIAL PROCESS* 83-86 (1963); T. LOWI, *THE END OF LIBERALISM: IDEOLOGY, POLICY, AND THE CRISIS OF PUBLIC AUTHORITY* 60-61 (1969); D. YATES, *BUREAUCRATIC DEMOCRACY: THE SEARCH FOR DEMOCRACY AND EFFICIENCY IN AMERICAN GOVERNMENT* 103-05 (1982).

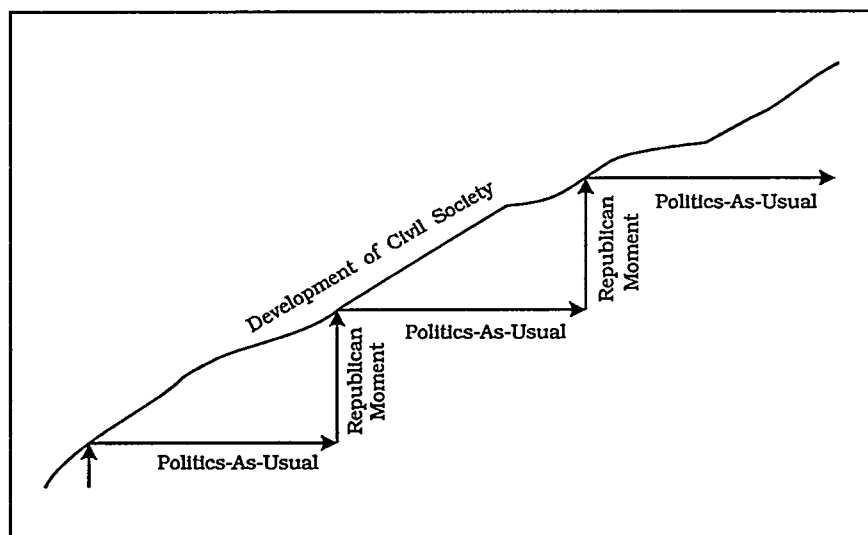
<sup>128</sup> See D. TRUMAN, *supra* note 6, at 467-68. Many observers have noted the existence of “iron triangles” composed of a government agency, an interest group beneficiary of the agency, and the congressional committee charged with overseeing the agency. Once an iron triangle gains control over an area of policy, it may be virtually impossible to dislodge. See P. ARONSON, *AMERICAN GOVERNMENT: STRATEGY AND CHOICE* 491 (1981); D. YATES, *supra* note 127, at 165.

<sup>129</sup> Walker, *A Critique of the Elitist Theory of Democracy*, 60 AM. POL. SCI. REV. 285, 292 (1966).

<sup>130</sup> The classic statement of this disjuncture is the Marxist dichotomy between base and superstructure, with the development at the base driven by advances in productive forces. See K. MARX & F. ENGELS, *THE GERMAN IDEOLOGY* 68-69 (R. Pascal ed. 1947). One need not, however, adopt a Marxist—or even a progressive—view of history to recognize that a stalemated state is likely to grow apart from the society it is attempting to govern.

a sort of "surrogate for revolution" that reconnects the state to civil society.<sup>131</sup> Using forms of direct popular power like mass demonstrations, strikes, and boycotts, social movements can force fundamental change onto the public agenda.<sup>132</sup> Republican moments, like the "critical elections" that tend to accompany them, respond to the "incapacity of 'politics as usual' to integrate, much less aggregate, emergent political demand."<sup>133</sup> The major milestones on the road to the current political order—independence, abolition, the rise of economic regulation, the integration of the industrial proletariat into capitalist democracy, and the extension of formal legal and political rights to racial minorities—were all products of republican moments.

Figure 1<sup>134</sup>



<sup>131</sup> See Burnham, *Revitalization and Decay: Looking Toward the Third Century of American Electoral Politics*, 38 J. POL., Aug. 1976, at 146, 149. Thus, direct popular involvement in agenda-setting may be "more important to the longrun stability of the system than electoral participation." R. COBB & C. ELDER, PARTICIPATION IN AMERICAN POLITICS: THE DYNAMICS OF AGENDA BUILDING 164 (1972).

<sup>132</sup> For illustrations of the agenda-setting function of popular protest, see R. COBB & C. ELDER, *supra* note 131, at 64-71.

<sup>133</sup> W. BURNHAM, *supra* note 85, at 10.

<sup>134</sup> This diagram is a modification of one that appears in F. ALBERONI, MOVEMENT AND INSTITUTION 9 (1984). In Alberoni's depiction, Revolution takes the place of Republican Moment, and Forces of Production that of Civil Society.

C. *Equalization from Below*

It is widely agreed that the normal operation of interest group pluralism systematically favors some groups over others. Not only does this violate the principle of political equality, but it also leads to a malfunction in the political marketplace. If all constituencies were equally represented, then legislators would be pressured to raise the total wealth of society. As long as the interest groups active on an issue represent substantially less than the entire population, they can agree on a solution that will benefit themselves by transferring wealth from the underrepresented constituencies.<sup>135</sup> Typically, this means enriching small, formally organized groups at the expense of larger, loosely organized groups.<sup>136</sup> In economic terms, the costs of the interest group deal "spill over" onto the underrepresented groups.<sup>137</sup> While corporations have been rightly identified as the big winners in the process,<sup>138</sup> other "entrenched oligarchies" such as labor unions and farm interests can exercise disproportionate influence under certain conditions.<sup>139</sup>

During republican moments, groups that are disadvantaged in interest-group bargaining develop unorthodox forms of direct popular power. The popular assemblies and boycott movements of the Revolutionary era helped to compensate for malfunctions in the representative process.<sup>140</sup> Reformers circumvented politics-as-normal during the Jacksonian era by calling state constitutional conventions.<sup>141</sup> Conservative women invaded the "gendered space" of taverns and saloons, while their radical counterparts parlayed female control of household consumption into collective power by boycotting such targets as British importers, slave

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<sup>135</sup> See K. SCHLOZMAN & J. TIERNEY, *ORGANIZED INTERESTS AND AMERICAN DEMOCRACY* 312-13 (1986). For a useful summary of the literature, see Farber & Frickey, *supra* note 11, at 906-07, 925.

<sup>136</sup> See M. EDELMAN, *THE SYMBOLIC USES OF POLITICS* 35-36 (1964); M. OLSON, *supra* note 15, at 41; K. SCHLOZMAN & J. TIERNEY, *supra* note 135, at 66-87.

<sup>137</sup> See M. HAYES, *supra* note 118, at 57-58.

<sup>138</sup> See C. LINDBLOM, *POLITICS AND MARKETS* 172 (1977). The critics of this view have been reduced to arguing, in effect, that it is impossible to prove who is a winner in interest group politics. See Wilson, *Democracy and the Corporation*, Wall St. J., Jan. 11, 1978, at 14, col. 4.

<sup>139</sup> See H. KARIEL, *THE DECLINE OF AMERICAN PLURALISM* 68-69 (1961); G. MCCONNELL, *PRIVATE POWER AND AMERICAN DEMOCRACY* 355-57 (1966).

<sup>140</sup> See D. HOERDER, *CROWD ACTION IN REVOLUTIONARY MASSACHUSETTS 1765-1780*, at 378-80 (1977); see also *infra* text accompanying notes 189-92 & 222-23.

<sup>141</sup> For a portrayal of these constitutional conventions as organs of popular sovereignty, see D. RODGERS, *supra* note 6, at 92-101.

industries, and discriminatory employers.<sup>142</sup> Industrial workers occupied factories and engaged in general strikes; African-Americans boycotted, sat in, and marched; and the list goes on.

Even groups that appear to be politically effective may in fact be poorly represented in politics-as-normal. The notion that leaders and paid lobbyists accurately represent their constituents' interests depends upon an idealized conception of group organization.<sup>143</sup> Leaders and paid staff develop distinct interests which do not necessarily coincide with those of the members.<sup>144</sup> Internal democracy—often the main channel for expressing views to leadership—rarely functions well at the national level.<sup>145</sup> Subgroups compete within large interest groups, replicating pluralist malfunctions on a smaller scale.<sup>146</sup> As a result, the policies pursued by group leaders and staffers often diverge widely from the interests of many or even most of the group's members.<sup>147</sup>

During republican moments, however, rank-and-file members are prone to rise up and reshape their organizations. In the 1930s, for example, a mass movement of industrial workers arose within the American Federation of Labor, which had been systematically ignoring their concerns, and drastically altered the balance of power between the craft and industrial unions and between industrial workers and their employers.<sup>148</sup> Similarly, in 1959, the NAACP

<sup>142</sup> For an analysis of the temperance movement's saloon invasions as highly effective exercises of direct popular power, see Chused, *Gendered Space*, 42 FLA. L. REV. 125, 130-35 (1990). On the role of women in boycotts, see S. EVANS, BORN FOR LIBERTY: A HISTORY OF WOMEN IN AMERICA 48-50, 259 (1989) and J. JONES, LABOR OF LOVE, LABOR OF SORROW: BLACK WOMEN, WORK AND THE FAMILY, FROM SLAVERY TO THE PRESENT 215-16, 279-80 (1985).

<sup>143</sup> See H. KARIEL, *supra* note 139, at 241-46.

<sup>144</sup> For classic, if somewhat extreme, statements of this problem, see R. MICHELS, POLITICAL PARTIES 136-63 (1915); M. WEBER, *The Social Psychology of the World Religions*, in FROM MAX WEBER: ESSAYS IN SOCIOLOGY 267, 297-301 (H. Gerth & C. Mills trans. & eds. 1946). For a more recent treatment, see F. PIVEN & R. CLOWARD, POOR PEOPLE'S MOVEMENTS: WHY THEY SUCCEED, HOW THEY FAIL (1977).

<sup>145</sup> The standard study is S. LIPSET, M. TROW & J. COLEMAN, UNION DEMOCRACY (1956).

<sup>146</sup> Thus, for example, Grant McConnell has shown that the Farm Bureau came to act for only a small, highly organized segment of its membership. See G. MCCONNELL, THE DECLINE OF AGRARIAN DEMOCRACY 173-81 (1953). Similarly, relatively compact and economically powerful subgroups within unions, like the skilled trades in the United Auto Workers and the over-the-road truckers in the Teamsters Union, exercise disproportionate influence over their unions.

<sup>147</sup> See *supra* note 144.

<sup>148</sup> The classic account is found in I. BERNSTEIN, THE LEAN YEARS: A HISTORY OF THE AMERICAN WORKER 1920-1933 (1960).

was forced by the bold sit-in tactics of young activists to endorse a campaign strategy that was not of its own choosing.<sup>149</sup> During such periods of upheaval, established interest group leaders must either embrace the rank-and-file initiative, as did the NAACP, or risk severe damage to their leadership positions, as occurred when the CIO split from the intransigent AFL. In either case, the constituency ends up with more responsive representatives.

#### D. *Republican Moments and the Threat of Totalitarianism*

In response to earlier versions of this Article, several readers argued that in celebrating direct popular power there is a risk of strengthening totalitarian movements. Although interest group pluralism's affirmative claims to fairness and efficiency may have been debunked, what about its defensive function as a bulwark against totalitarian dictatorship? This argument brings us full circle, back to the early days of modern liberal pluralism.

Interest-group pluralism originated as a defensive reaction to the totalitarian threat of the mid-twentieth century. To the liberal intellectuals of that period, the central problem of political science was preserving formal democratic institutions against the brutal menaces of Nazism and Stalinism.<sup>150</sup> Many located the social basis of totalitarianism in the lower classes, and its political expression in ideological politics.<sup>151</sup>

Their solution embodied the two main principles of Madisonian democracy. First, the people—especially the lower classes—should be discouraged from uniting in an ideological movement.<sup>152</sup> As long as politics consisted of narrowly self-interested deals, no broad-based ideological movement would emerge. Second, effective power should be concentrated in elites that could—at least relatively speaking—rise above popular passions and prejudices.

From this perspective, republican moments are nightmares. Social movements mobilize broad sectors of the population into

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<sup>149</sup> See A. MORRIS, *THE ORIGINS OF THE CIVIL RIGHTS MOVEMENT: BLACK COMMUNITIES ORGANIZING FOR CHANGE* 192, 216 (1984).

<sup>150</sup> See E. PURCELL, *THE CRISIS OF DEMOCRATIC THEORY: SCIENTIFIC NATURALISM AND THE PROBLEM OF VALUE* 197-217 (1973); D. RODGERS, *supra* note 6, at 209.

<sup>151</sup> See S. LIPSET, *POLITICAL MAN* 87-126 (1981); D. TRUMAN, *supra* note 6, at 522.

<sup>152</sup> The pluralist intellectuals tried to discourage ideological politics by declaring them impossible. America had, they proclaimed, moved beyond ideology to a pragmatic consensus. See D. BELL, *THE END OF IDEOLOGY* 393-407 (revised ed. 1962); S. LIPSET, *supra* note 151, at 439-56. For a more critical view of the consequences of consensus, see L. HARTZ, *THE LIBERAL TRADITION IN AMERICA* 302-09 (1955).



passionate, ideological action. Interest group leaders are shoved aside. Representative institutions are bypassed or pressured with extra-institutional forms of power.

As the pre-eminent pluralist Robert Dahl has observed, however, defensive pluralism makes a "sort of fetish" out of stability and consensus, ignoring the "astonishing" amount of conflict and change that democracies have absorbed.<sup>153</sup> The democratic rights that we celebrate today were all won by unruly and ideological movements. Defensive pluralists would have us believe that these origins are irrelevant to preserving democracy. As Huntington has shown, however, democratic ideals cannot survive without periodic rejuvenation by popular movements—a belief shared, as we shall see, by many Americans of the founding generation. Totalitarian movements find their most fertile soil in the political anomie that results from stalemated politics and popular disempowerment.

The democratic impact of republican moments should not be overstated. Historians have argued that many of the Progressive Era and New Deal reforms reflected efforts by corporate elites to fine-tune the market and head off radical change.<sup>154</sup> Moreover, during the 1960s—the only republican moment since the rise of the administrative state—the civil rights movement was co-opted into many incrementalist projects.<sup>155</sup> But the failure of republican moments to displace interest group politics completely should not blind us to the fact that they encompass the most vigorous exercises of democracy yet undertaken by the American people. As such, they provide the natural starting point for efforts to involve the citizenry in strengthening democracy.

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<sup>153</sup> See R. DAHL, *PLURALIST DEMOCRACY IN THE UNITED STATES: CONFLICT AND CONSENT* 261 (1967).

<sup>154</sup> Some contend that this was the central significance of the reforms. See, e.g., G. KOLKO, *THE TRIUMPH OF CONSERVATISM* 285-87 (1963) (concerning the Populist-Progressive Era); Ferguson, *supra* note 104, at 3. A more accurate view holds, however, that corporate elements exercised considerable but by no means controlling influence over the ultimate direction of reform. On the New Deal, see Hawley, *The Discovery and Study of a "Corporate Liberalism,"* 52 *BUS. HIST. REV.* 309, 314, 318 (1978); see also *supra* note 100 and accompanying text. On the Populist-Progressive era, see, e.g., Hovenkamp, *Regulatory Conflict in the Gilded Age: Federalism and the Railroad Problem*, 97 *YALE L.J.* 1017, 1027 (1988) (observing that although federal railroad regulation may have been enacted to promote railroad interests, state statutes were intended "to improve the economic welfare of resident farmers").

<sup>155</sup> See T. LOWI, *supra* note 127, at 226-49; F. PIVEN & R. CLOWARD, *REGULATING THE POOR* 198, 272-76 (1971).

## IV. REPUBLICAN MOMENTS AND THE CONSTITUTION

The Constitution and Bill of Rights were themselves products of a republican moment, a time when "every order and degree among the people" had begun "to dispute on politics and positively to determine upon our liberties."<sup>156</sup> Given this genesis, it would be surprising if these founding documents did not express some position on the status of popular republican politics in our constitutional order.

In the traditional view, the Constitution was a reaction to the "democratic excesses" of the Confederation period—an attempt, in effect, to terminate the republican moment and reestablish politics-as-normal within a framework of representative government.<sup>157</sup> This view is accurate as far as it goes.<sup>158</sup> Any attempt to find a constitutional home for popular republican politics must confront the fact that the body of the Constitution was intended to repudiate direct democracy and to establish representative government.

But liberal pluralist theory has attempted to go further, interpreting subsequent amendments in light of the traditional view. The first amendment is said to be primarily concerned with activities that are integral to representative politics-as-normal, for example, speech that seeks to influence elections or comment upon public officials.<sup>159</sup> John Ely and Jesse Choper built this view into a comprehensive theory, arguing that the entire Constitution, including the Bill of Rights and the Reconstruction Amendments, should be interpreted so as to facilitate the functioning of representative government.<sup>160</sup>

At first glance, the liberal pluralist view has the advantage of structural consistency. Given that the body of the Constitution clearly sets up the machinery for representative government, why not treat the relatively vague commands of the first amendment as if they were accessories?

<sup>156</sup> G. WOOD, *supra* note 29, at 6 (quoting contemporary observers).

<sup>157</sup> See *infra* text accompanying notes 248-56.

<sup>158</sup> See *infra* text accompanying notes 253-56.

<sup>159</sup> See A. MEIKLEJOHN, *FREE SPEECH AND ITS RELATION TO SELF-GOVERNMENT* 22-27 (1948). For more recent arguments along these lines, see Bevier, *The First Amendment and Political Speech: An Inquiry Into the Substance and Limits of Principle*, 30 STAN. L. REV. 299, 304-22 (1978); Bork, *Neutral Principles and Some First Amendment Problems*, 47 IND. L.J. 1, 17-20 (1971).

<sup>160</sup> See J. CHOPER, *supra* note 8, at 1-12; J. ELY, *supra* note 8, at 88-101.

The history of republican moments suggests another possibility. From a functional point of view, the constitutional order might best be served not by reducing the first amendment to a guarantee of politics-as-normal, but by permitting and even encouraging the practice of popular republican politics outside the framework of representative government. In this view, the first amendment would encompass direct exercises of group power, thus providing a popular supplement to representative government.<sup>161</sup>

The following sections assess the textual and historical support for the possibility of a popular republican supplement, focusing on the right of the people peaceably to assemble. Although the history presented here is in the service of the broader project on republican moments, I hope that it will not do too much violence to the historian's concern with "[n]uance and change."<sup>162</sup> The account takes as its starting point the centrality of the relation between the legal theory and political practice of the Revolutionary and Confederation periods.<sup>163</sup>

#### A. *Republican Moments in the Political Thought and Practice of the Founding Generation*

Most of the American founders and their English Radical Whig mentors believed strongly in the need for popular action outside regularly established government. James Burgh advised that in "planning a government by representation, the people ought to provide against their own *annihilation*" by establishing "a regular and constitutional method of acting by and from *themselves*, without,

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<sup>161</sup> The theory of republican moments thus adds support to constitutional theories that maintain a role for popular power. See, e.g., C.E. BAKER, HUMAN LIBERTY AND FREEDOM OF SPEECH 108-24 (1989) (contending that the liberty theory of the first amendment provides the possibility for nonhierarchical noninstrumental means for radical democratic change); Blasi, *The Checking Value in First Amendment Theory*, 1977 AM. B. FOUND. RES. J. 521 (suggesting that by protecting the flow of information, the first amendment enables the people to check government abuses); see also S. SHIFFRIN, THE FIRST AMENDMENT, DEMOCRACY, AND ROMANCE 96-100 (1990); Ackerman, *supra* note 73.

<sup>162</sup> See Soifer, *Protecting Civil Rights: A Critique of Raoul Berger's History*, 54 N.Y.U. L. REV. 651, 654 (1979).

<sup>163</sup> See Rabban, *The Ahistorical Historian: Leonard Levy on Freedom of Expression in Early American History* (Book Review), 37 STAN. L. REV. 795, 799-801 (1985). As John Phillip Reid observed, even legally untrained Whigs considered themselves fully capable of making legal judgments, which they frequently did in political discourse. See Reid, *In a Defensive Rage: The Uses of the Mob, The Justification in Law, And the Coming of the American Revolution*, 49 N.Y.U. L. REV. 1043, 1044 n.9 (1974).

or even in opposition to their *representatives*, if necessary."<sup>164</sup> In *Cato's Letters*, John Trenchard asserted the people's right of petition (which, in his view, included not only the right to be heard, but also to obtain relief), and argued that the distinctive feature of free countries "lies principally here, that . . . their Magistrates must consult the Voice and Interest of the People."<sup>165</sup> Joseph Priestly observed that the "*sense of the people*" though "no nominal part of the constitution . . . and though it is only expressed by talking, writing, and petitioning," nevertheless operates as a "real check" on government because "tumults and insurrections so often arise when the voice of the people is loud, that the most arbitrary governments dread the effects of them."<sup>166</sup>

Since rulers inevitably tended toward corruption and tyranny, the people had the right and the duty to defend their liberties—by armed force if necessary.<sup>167</sup> Rebellion and tumult served notice that, as Samuel Adams put it, the "wheels of good government" were clogged.<sup>168</sup> Even cautious Whigs like John Adams, not to mention Alexander Hamilton and James Madison, could endorse "Popular Commotions" when "Fundamentals are invaded" by government.<sup>169</sup> Thus, insurrections could be interpreted as "Symp-

<sup>164</sup> 1 J. BURGH, POLITICAL DISQUISITIONS 6 (1774).

<sup>165</sup> 2 J. TRENCHARD, CATO'S LETTERS 42-43 (1733) [hereinafter CATO'S LETTERS]; see also 3 CATO'S LETTERS, *supra*, at 21. Trenchard, however, took a dimmer view of crowd action than some of his Whig colleagues when he warned against "public Disturbances" because the consequences could not be foreseen. See 1 CATO'S LETTERS, *supra*, at 193.

<sup>166</sup> J. PRIESTLY, LECTURES ON HISTORY AND GENERAL POLICY 340 (1788) (J. Rutt ed. 1826).

<sup>167</sup> See P. GILJE, THE ROAD TO MOBOCRACY 8 (1987); P. MAIER, FROM RESISTANCE TO REVOLUTION: COLONIAL RADICALS AND THE DEVELOPMENT OF AMERICAN OPPOSITION TO BRITAIN, 1765-1776, at 42-43; Reid, *supra* note 163, at 1050-53.

<sup>168</sup> 1 THE WRITINGS OF SAMUEL ADAMS 237 (H. Cushing ed. 1904).

<sup>169</sup> Letter from John Adams to Abigail Adams (July 7, 1774), in 1 ADAMS FAMILY CORRESPONDENCE 130-31 (L. Butterfield ed. 1963), quoted in G. WOOD, *supra* note 29, at 321. Hamilton and Madison acknowledged the existence and legitimacy of the right of resistance in the *Federalist Papers*, with Hamilton going so far as to argue—in an odd departure from his usual distrust of popular tumult—that power should be centered in national rather than state government because popular resistance would have "infinitely better prospect of success" against national rulers than against those of an individual state. THE FEDERALIST NO. 28, *supra* note 5, at 180 (A. Hamilton); see also THE FEDERALIST NO. 46, *supra* note 5, at 298 (J. Madison) (stating that "ambitious encroachments of the federal government" would be met by organized resistance); THE FEDERALIST NO. 60, *supra* note 5, at 369 (A. Hamilton) (stating that an attempt by the federal government to make improper use of its power to regulate

toms of a strong and healthy Constitution."<sup>170</sup>

Thomas Jefferson developed this theme in a way that closely presaged the subsequent experience with republican moments. Political turbulence was "as necessary in the political world as storms in the physical."<sup>171</sup> It helped to sustain a politically aware citizenry by nourishing "a general attention to the public affairs."<sup>172</sup> Periodic rebellions would hold governors to "the true principles of their institution,"<sup>173</sup> thus narrowing the gap between republican ideals and institutional practice. Without popular tumults, governors would become "wolves," and there would be a "general prey of the rich on the poor."<sup>174</sup> "God forbid," wrote Jefferson, "that we should ever be" without a rebellion for 20 years<sup>175</sup>—a fair anticipation of the average interval between nationwide republican moments.

The American founders saw popular resistance not as a means of pressing for change, but as a defense against tyrannical government. Republican moments, on the other hand, have brought wrenching transformations in political, social, and economic life. Both constructs are, however, concerned with the same underlying problem: the natural tendency of government to become estranged from the people and to diverge from the pursuit of the public

elections would cause "an immediate revolt of the great body of the people"). Violent remedies would not, however, be justified for mere "partial or occasional distempers of the State," for which the remedy was "a change of men." THE FEDERALIST NO. 21, *supra* note 5, at 140 (A. Hamilton). Indeed, one of the principal reasons for forming a strong national government was its utility in suppressing "partial commotions and insurrections . . . from the intrigues of an inconsiderable faction." THE FEDERALIST NO. 16, *supra* note 5, at 117 (A. Hamilton); *see also* THE FEDERALIST NO. 27, *supra* note 5, at 175 (A. Hamilton) (arguing that a strong national government would be more likely to discourage sedition than the state governments); THE FEDERALIST NO. 43, *supra* note 5, at 276-80 (J. Madison) (arguing that a national government will provide protection against domestic insurrections).

<sup>170</sup> P. MAIER, *supra* note 167, at 23 (quoting Josiah Quincy). For additional contemporary statements, *see id.* at 22-24; P. GILJE, *supra* note 167, at 7-9.

<sup>171</sup> Letter from Thomas Jefferson to James Madison (Jan. 30, 1787), in 11 JEFFERSON PAPERS, *supra* note 2, at 92, 93.

<sup>172</sup> *Id.* Thus, rebellion was "a medicine necessary for the sound health of government." *Id.*

<sup>173</sup> Letter from Thomas Jefferson to Edward Carrington (Jan. 16, 1787), in 11 JEFFERSON PAPERS, *supra* note 2, at 48, 49. Tumult thus served as "the only safeguard of the public liberty." *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> Letter from Thomas Jefferson to William Stephens Smith (Nov. 13, 1787), in 12 JEFFERSON PAPERS, *supra* note 2, at 355-56.

interest. And both prescribe the same remedy: massive and forceful political intervention by the citizenry.<sup>176</sup>

A strong case might be made that the right of resistance was incorporated into the Constitution via the second amendment right to bear arms,<sup>177</sup> or that it is among those rights that were retained by the people in the ninth amendment.<sup>178</sup> But the right of resistance does not provide an adequate home for popular republican politics. In its traditional formulation, the right was narrowly circumscribed. Resistance would be justified only if government abuses were so widespread, notorious, and unlawful as to amount to tyranny.<sup>179</sup> It could not be exercised by a few individuals or a small faction; participation by the whole "Body of the People" was, at least in theory, essential.<sup>180</sup> To limit republican politics to situations where they could be justified under the right of resistance

<sup>176</sup> See *infra* notes 117-55 and accompanying text.

<sup>177</sup> See, e.g., Kates, *Handgun Prohibition and the Original Meaning of the Second Amendment*, 82 MICH. L. REV. 204, 221-22 (1983) (noting that support for the right of resistance was one of the impulses behind the second amendment); Levinson, *The Embarrassing Second Amendment*, 99 YALE L.J. 637, 648-50 (1989) (observing that commentators from 1787 into the twentieth century have argued that an armed populace is necessary to prevent tyrannical acts by the government).

<sup>178</sup> Cf. Paust, *The Human Right to Participate in Armed Revolution and Related Forms of Social Violence: Testing the Limits of Permissibility*, 32 EMORY L.J. 545, 545-47, 550-55 (1983) (arguing that the founders regarded the right of revolution as arising from natural law, and noting that the Declaration of Independence, the Declaration of the Causes and Necessity of Taking up Arms, and several state constitutions assert the right).

<sup>179</sup> See P. MAIER, *supra* note 167, at 35, 40-41. The requirement of unlawfulness was not a technical, legal judgment. The Whigs recognized that the law was so "ambiguous, perplexed, and intricate" that the real question was whether the ruler had acted against the public good. A. SIDNEY, *DISCOURSES CONCERNING GOVERNMENT* 418 (London 3d ed. 1751), *quoted in* P. MAIER, *supra* note 167, at 37. For example, although the proposed constitution empowered Congress to regulate the "Times, Places and Manner" of holding elections for Senators and Representatives, U.S. CONST. art. I § 4, Hamilton argued that a congressional attempt to confine "the places of election to particular districts" thus "rendering it impracticable to the citizens at large to partake in the choice" would properly result in an "immediate revolt of the great body of the people, headed and directed by the State governments." THE FEDERALIST NO. 60, *supra* note 5, at 367 (A. Hamilton).

<sup>180</sup> See P. MAIER, *supra* note 167, at 35-36; Paust, *supra* note 178, at 553-55; Reid, *supra* note 163, at 1050. In practice, this requirement meant something substantially less than unanimous support. It is estimated that up to 20 percent of the white population retained its loyalty to Britain throughout the revolution. See Smith, *The American Loyalists: Notes on Their Organization and Numerical Strength*, 25 WM. & MARY Q. 259, 269 (3d Ser. 1968). To this number must be added a substantial group that remained undecided.

would thus be to relegate them to the fringes of our constitutional order.

Armed resistance was not, however, the only form of extra-legal popular action during the Revolutionary era. There was an intermediate level of popular involvement more forceful than polite petitioning but less so than violent resistance. Activities in this category included peaceful demonstrations, boycotts, and social ostracism.<sup>181</sup> These activities performed some of the same functions as rebellion, for example arousing the people and holding governors to the "true principles of their institution," but at less cost in life and property. They were precisely the kinds of participation that, as we have seen, typically displace politics-as-normal during republican moments.<sup>182</sup> Their unifying feature was the nonviolent exercise of popular power outside the established institutions of government.

The legal justifications for this type of political action were intimately bound up with the development of the right of the people peaceably to assemble. The remainder of this Part suggests that a home for republican moments may be found in the first amendment's guarantee of that right. In making this claim, I do not mean to imply that courts deciding first amendment cases should stress the distinctions among the rights of assembly, petition, and free speech. Courts quite properly downplay these formal distinctions and instead assess political activities in light of the broad purposes of all three clauses.<sup>183</sup> My claim is that the assembly clause, read in historical context, adds the protection of popular republican political action to those broad purposes.

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<sup>181</sup> See Conser, McCarthy & Toscano, *The American Independence Movement, 1765-1775: A Decade of Nonviolent Struggles*, in *RESISTANCE, POLITICS, AND THE AMERICAN STRUGGLE FOR INDEPENDENCE, 1765-1775*, at 3 (W. Conser, R. McCarthy, D. Toscano & G. Sharp eds. 1986); see also *infra* notes 189-92 and accompanying text.

<sup>182</sup> See *supra* text accompanying notes 140-42. Republican moments are usually accompanied by violence as well. Typically, however, the impetus for serious violence comes from forces opposed to transformative social movements. As Gordon Wood has observed, for example, the contrast between the purportedly restrained American revolutionary mobs and the violent French ones was due not to any violent propensity of French mobs, but to the violence of the French government's reaction as compared to the relatively peaceful response of British and colonial authorities to American mobs. See Wood, *A Note on Mobs in the American Revolution*, 23 WM. & MARY Q. 635, 639-42 (3d Ser. 1966). See generally *AMERICAN VIOLENCE: A DOCUMENTARY HISTORY* (R. Hofstadter & M. Wallace eds. 1970) (collecting contemporary accounts of American uprisings from 1634 to 1968).

<sup>183</sup> See *NAACP v. Button*, 371 U.S. 415, 429-30 (1963); J. NOWAK, R. ROTUNDA, & J. YOUNG, *CONSTITUTIONAL LAW* § 16.53, at 1004 (3d ed. 1986).

B. *Revolutionary Origins of the Right of Assembly*

In 1774, the Continental Congress declared the right of the people "peaceably to assemble, consider of their grievances, and petition the king."<sup>184</sup> This right, which was not expressly recognized in British law,<sup>185</sup> was asserted in response to its attempted suppression by Parliament earlier that year.<sup>186</sup> The Massachusetts Government Act of 1774, one of the "Intolerable Acts," had prohibited citizens from calling meetings "without the leave of the governor," except for specified purposes.<sup>187</sup> In explanation, Parliament chastised the people for abusing their authorization "to assemble together" by treating "upon matters of the most general concern" (meaning telling Parliament how to run the Empire) and passing "many dangerous and unwarrantable resolves."<sup>188</sup>

These "abuses" dated back to the Stamp Act of 1765. After an initial outbreak of violence, American leaders had turned to the relatively peaceful strategy of boycotting British goods and refusing to comply with oppressive laws.<sup>189</sup> Nonimportation associations

<sup>184</sup> Declaration of Rights, 14 October 1774, *Journal of the Proceedings of the First Congress Held at Philadelphia Sept. 5, 1774*, at 62 (1774 & reprint 1974), reprinted in SOURCES OF OUR LIBERTIES: DOCUMENTARY ORIGINS OF INDIVIDUAL LIBERTIES IN THE UNITED STATES CONSTITUTION AND BILL OF RIGHTS 286, 288 (R. Perry ed. 1959) [hereinafter SOURCES] (emphasis added) ("Resolved . . . That they have a right peaceably to assemble, consider of their grievances, and petition the king; and that all prosecutions, prohibitory proclamations, and commitments for the same, are illegal.").

<sup>185</sup> According to Bernard Schwartz, the Declaration of the Continental Congress was the first authoritative document to assert the right of assembly. See B. SCHWARTZ, *THE GREAT RIGHTS OF MANKIND: A HISTORY OF THE AMERICAN BILL OF RIGHTS* 198 (1977). The English Bill of Rights guaranteed the right to petition but did not mention assembly. See Bill of Rights, 1688, 1 W. & M. ch. 2, § 5, reprinted in SOURCES, *supra* note 184, at 246 (stating "[t]hat it is the right of the subjects to petition the King, and all commitments and prosecutions for such petitioning are illegal.").

Those who argue that the right was recognized in English law rely not on any explicit declarations, but on the pattern of common law holdings and statutory restrictions. See Jarrett & Mund, *The Right of Assembly*, 9 N.Y.U. L.Q. REV. 1, 5-10 (1931). This is not, however, a legal right in the strong sense. What existed in England might be better described as the *potential* for an affirmative right of assembly to be implied from existing law. In 1781, the King's Bench declined an opportunity to imply such a right from the right of petition. See *infra* note 202.

<sup>186</sup> See 1 J. REID, *CONSTITUTIONAL HISTORY OF THE AMERICAN REVOLUTION* 24-25 (1986).

<sup>187</sup> Massachusetts Government Act, 14 Geo. 3, ch. 45, § 7 (1774).

<sup>188</sup> *Id.*

<sup>189</sup> See D. HOERDER, *CROWD ACTION IN REVOLUTIONARY MASSACHUSETTS 1765-1780*, at 115 (1977); P. MAIER, *supra* note 167, at 73-74; Conser, *The Stamp Act*



openly engaged in nonviolent coercion against importers. Meetings voted to "Expose to shame and Contempt" all offenders.<sup>190</sup> Boycott violators were themselves boycotted, often with devastating effect.<sup>191</sup> Crowds of nonimportation supporters visited offenders to demand compliance.<sup>192</sup> In short, the resistance movement employed the kind of intense and impolite protest tactics that are characteristic of republican moments.

These tactics were consciously chosen as "legal & peaceable" alternatives to rioting.<sup>193</sup> While "riots and tumults" might be illegal, it could "be no breach of the laws of nature nor of our country for people to assemble together peaceably."<sup>194</sup> If respectful petitions were ignored, John Dickinson argued, "then that kind of opposition becomes justifiable, which can be made without breaking the laws, or disturbing the public peace," namely "withholding from Great-Britain, all the advantages she has been used to receive from us."<sup>195</sup> When Lieutenant Governor Thomas Hutch-

*Resistance*, in *RESISTANCE, POLITICS, AND THE AMERICAN STRUGGLE FOR INDEPENDENCE, 1765-1775*, *supra* note 181, at 22, 31-37. I say "relatively" because nonimportation and nonconsumption were never entirely severed from violence in practice, and during some periods, violent enforcement of the boycott was common. See D. HOERDER, *supra*, at 204-15.

<sup>190</sup> See D. HOERDER, *supra* note 189, at 206; P. MAIER, *supra* note 167, at 122.

<sup>191</sup> See P. MAIER, *supra* note 167, at 122-23. The boycott also had serious consequences for many citizens who did not import themselves, but who were connected to industries related to the British trade. Tailors suffered because of the boycott of British cloth, and shipyard workers were hurt by the decline in ship-borne trade. See C. BRIDENBAUGH, *CITIES IN REVOLT: URBAN LIFE IN AMERICA, 1743-1776*, at 283 (1955).

<sup>192</sup> See P. MAIER, *supra* note 167, at 126-27; Reid, *supra* note 163, at 1081.

<sup>193</sup> As George Mason put it, the colonists had no alternative but to prevent "by all legal & peaceable Means in our Power (for we must avoid even the Appearance of Violence) the Importation of the enumerated goods." Letter from George Mason to Richard Henry Lee (June 7, 1770), in 1 *PAPERS OF GEORGE MASON 1725-1792*, at 116 (R. Rutland ed. 1970) [hereinafter *MASON PAPERS*]; see also D. HOERDER, *supra* note 189, at 115; P. MAIER, *supra* note 167, at 114. Nonimportation associations typically declared themselves to be lawful. See, e.g., *Nonimportation Agreement of June 28, 1769*, in *THE LETTERS OF FREEMAN, ETC.: ESSAYS ON THE NONIMPORTATION MOVEMENT IN SOUTH CAROLINA* 5, 5 (W. Drayton ed. 1771) (R. Weir ed. 1977) [hereinafter *LETTERS OF FREEMAN*] (describing nonimportation as a "loyal and vigorous" method); *Virginia Nonimportation Association*, in *MASON PAPERS*, *supra*, at 120, 121 (declaring it to be the duty of every citizen to prevent the ruin of his country "by every lawful means").

<sup>194</sup> *Pa. J., Supplement*, Feb. 6, 1766, quoted in P. MAIER, *supra* note 167, at 72; see also, G. WOOD, *supra* note 29, at 312 (observing that it was the "right of assembly that justified the numerous associations and congresses that sprang up during the Stamp Act crisis").

<sup>195</sup> J. DICKINSON, *LETTERS FROM A FARMER IN PENNSYLVANIA TO THE INHABITANTS OF THE BRITISH COLONIES* 31-35 (1903). Dickinson's writings were highly influential

inson of Massachusetts complained that Boston's nonimportation assembly was unlawful and should be immediately disbanded, local justices of the peace responded that there had been insufficient disorder to justify suppression.<sup>196</sup> To Hutchinson, the justices' response missed the point. A few months earlier, he had written that he had found "by experience, that associations and assemblies, pretending to be legal and constitutional and assuming powers which belong only to the Established authority prove more fatal to this authority, than mobs, riots, and the mass tumultuous disorders."<sup>197</sup>

Some conservatives contended that the nonimportation associations were unlawful conspiracies even when their activities were entirely peaceable. They argued that a combination or "confederacy" to coerce citizens into boycotting was criminal and seditious.<sup>198</sup> But the nonimportation activists countered that they could not be prosecuted for combining to commit legal acts; no law compelled them to purchase British goods or to patronize or associate with people who did.<sup>199</sup> It is unclear which side had the

and, according to Benjamin Franklin, spoke the "general sentiments" of the American people at that time. See D. JACOBSON, JOHN DICKINSON AND THE REVOLUTION IN PENNSYLVANIA 1764-1776, at 57 (1965).

<sup>196</sup> See Letter from Thomas Hutchinson to Hillsborough (Jan. 24, 1770), in 1 SPARKS MANUSCRIPTS, BRITISH PAPERS RELATING TO THE AMERICAN REVOLUTION 116 (handcopied papers located at the Houghton Library at Harvard University).

<sup>197</sup> Letter from Thomas Hutchinson to Hillsborough (Oct. 20, 1769), in 3 SPARKS MANUSCRIPTS, PAPERS RELATING TO NEW ENGLAND 41.

<sup>198</sup> According to Thomas Hutchinson, for "particular persons to forbear importing cannot be deemed criminal, but it is quite another thing for numbers to confederate together and compel others to join them, and all with an avowed design to force the legislature to repeal their acts." B. BAILYN, THE ORDEAL OF THOMAS HUTCHINSON 133 (1974) (quoting Hutchinson). William Henry Drayton likewise acknowledged that individuals might refrain from importing, but a "confederacy" for that purpose would unlawfully "oblige a man to act contrary to his inclination." Letter from Freeman (William Henry Drayton) to Libertas et Natali Solum (Oct. 12, 1769), in LETTERS OF FREEMAN, *supra* note 193, at 42, 47-48.

<sup>199</sup> According to John Mackenzie, the "association assumes no other right" than the individual right to withhold patronage, and as for social ostracism, that was "a mere matter of opinion, which men will ever exercise, without entering into associations." Not satisfied with this formalistic argument, Mackenzie acknowledged that,

[t]o be sure, the greater the numbers, the greater the weight. That it is an hardship, men should be constrained to enter into such measures, no body will deny: but let us put the saddle upon the right horse; Those who have rendered such measures necessary, are answerable for the uncommon roads they force mankind to take.

better of the argument under English law,<sup>200</sup> but there is no doubt which prevailed among the American leaders. As one nonimportation leader put it, "every body of English freemen" possessed an "undeniable constitutional right" to boycott "if they think it necessary for their preservation."<sup>201</sup>

The colonists' identification of nonviolence as the touchstone of legality was reflected in colonial law. No colonial legislature passed any law resembling the English Tumultuous Petitioning Act of 1661, which criminalized assemblies engaged in nothing more than nonviolent petitioning.<sup>202</sup> A number of colonies did, however, respond to outbreaks of armed rioting and vigilantism by passing riot acts. Like the English Riot Act of 1714,<sup>203</sup> these laws prohibited some number of people (usually twelve, but sometimes as few as three) from remaining unlawfully assembled for more than one

Letter by A Member of the General Committee (John Mackenzie) (Sept. 28, 1769), in *LETTERS OF FREEMAN*, *supra* note 193, at 33, 38. See generally P. MAIER, *supra* note 167, at 130-31 (discussing the attempts of the movement's leaders to avoid the taint of illegality).

At times, the justification of nonimportation activities shaded into invocations of the right of resistance. The Americans had been, according to Christopher Gadsden, "reduced to a necessity of associating together, in order to discover, and unite in, some common means, for the recovery and preservation of their rights and liberties." Letter from Christopher Gadsden to Peter Timothy 7 (Oct. 26, 1769), in *LETTERS OF FREEMAN*, *supra* note 193, at 52, 67.

<sup>200</sup> In arguing that a confederacy was unlawful, see *supra* note 198, Drayton was relying on language in the Poulterers' Case, 77 Eng. Rep. 813, 815 (K.B. 1611). This was, however, vague dictum; the case involved a conspiracy to obtain the arrest and conviction of an innocent person. Maier found no case decided prior to or contemporaneously with the American Revolution in which a peaceful boycott was held to be an unlawful conspiracy. See P. MAIER, *supra* note 167, at 132.

<sup>201</sup> Letter from Christopher Gadsden to Peter Timothy (Oct. 26, 1769), in *LETTERS OF FREEMAN*, *supra* note 193, at 57, 67 (emphasis omitted); see also *supra* notes 193-97 and accompanying text.

<sup>202</sup> See An Act Against Tumults and Disorders Upon Pretence of Preparing or Presenting Public Petitions or Other Addresses to His Majesty or the Parliament, 13 Car. 2, st. 1, ch. 5. The Act limited to 20 the number of people who could sign a petition to the King, and to 10 the number who could approach the King or Parliament "upon pretence of presenting or delivering any petition." *Id.* In the case of Lord George Gordon, Lord Mansfield ruled that the English Bill of Rights, which guaranteed the "right of the subjects to petition the King," had not repealed this law. *The King v. Lord George Gordon*, 99 Eng. Rep. 372, 374 (K.B. 1781).

<sup>203</sup> See An Act for Preventing Tumults and Riotous Assemblies, and for the More Speedy and Effectual—Punishing the Rioters, 1 Geo. 2, ch. 5 [hereinafter English Riot Act of 1714]. This law authorized the violent suppression of any group of 12 or more people who remained "unlawfully, riotously, and tumultuously assembled together, to the disturbance of the publick peace" for more than one hour after being read the riot act. *Id.*

hour after having been "read the riot act."<sup>204</sup> The unlawfulness derived either from the commission of a violent act or the intent to commit one.<sup>205</sup>

Although the colonial riot acts contained language vague enough,<sup>206</sup> and punishments severe enough<sup>207</sup> to make a modern first amendment scholar cringe, it appears that in practice they were directed against specific instances of open, armed rebellion. The New York legislature acted after the Green Mountain Boys had carried out numerous armed attacks on New Yorkers.<sup>208</sup> In New Jersey, groups of citizens had repeatedly broken into jails to rescue prisoners.<sup>209</sup> North Carolina's law was passed after adherents of the Regulator movement attacked and beat court officials.<sup>210</sup> By the time the Pennsylvania legislature acted, the Paxton Boys were already marching toward Philadelphia with the avowed purpose of capturing and killing Indians who were there under military protection.<sup>211</sup> Only Connecticut moved before a major outbreak of popular violence. Its legislature was responding to a single jail rescue.<sup>212</sup> In an important departure from the English act, all but

<sup>204</sup> See, e.g., An Act for preventing and suppressing of Riots, Routs, and unlawful Assemblies, Acts 1750, ch. 12 [hereinafter Massachusetts Riot Act of 1750]; An Act for Preventing Tumults and Riotous Assemblies and for the More Speedy and Effectual Punishing the Rioters, Acts 1764, reprinted in 6 STATUTES AT LARGE OF PENNSYLVANIA 325-28 (1899) [hereinafter Pennsylvania Riot Act of 1764]. The other colonies to pass riot acts were Connecticut (1722), New Jersey (1747), New York (1774), and North Carolina (1771). See P. MAIER, *supra* note 167, at 24-25.

<sup>205</sup> See, e.g., Massachusetts Riot Act of 1750, *supra* note 204 (participants must be "unlawfully, riotously or tumultuously assembled"); Pennsylvania Riot Act of 1764, *supra* note 204, at 325 (participants must be "unlawfully, riotously, and tumultuously assembled together to the disturbance of the public peace"). This general language was drawn from the English Riot Act of 1714, *supra* note 203, at 1 Geo. 2, ch. 5, § 1. The offense of unlawful assembly required only a purpose "to do an unlawful act, as to pull down enclosures, to destroy a warren or the game therein." 4 W. BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND \*146.

<sup>206</sup> See *supra* note 205.

<sup>207</sup> Pennsylvania imposed the death penalty. See Pennsylvania Riot Act of 1764, *supra* note 204, at 326. More typically, Massachusetts called for 39 or 40 stripes across the naked back in addition to imprisonment and fines or property forfeitures. See Massachusetts Riot Act of 1750, *supra* note 204. These penalties were considered brutal even at the time. See C. BRIDENBAUGH, *supra* note 191, at 117.

<sup>208</sup> See D. FOX, YANKEES AND YORKERS 169 (1940).

<sup>209</sup> See 7 DOCUMENTS RELATING TO THE COLONIAL HISTORY OF THE STATE OF NEW JERSEY 117-304 (1883).

<sup>210</sup> See H. LEFLER & W. POWELL, COLONIAL NORTH CAROLINA: A HISTORY 234-37 (1973).

<sup>211</sup> See J. KELLEY, PENNSYLVANIA: THE COLONIAL YEARS 1681-1776, at 494-95 (1980).

<sup>212</sup> See R. TAYLOR, COLONIAL CONNECTICUT: A HISTORY 175 (1979).

Connecticut's expired by their own terms after periods of one to three years.<sup>213</sup>

Despite their limited practical reach, the riot acts were heartily opposed by many colonials as unwarranted intrusions on liberty.<sup>214</sup> By the 1770s, only one of the temporary laws—New York's—remained in effect, and in 1778 it was repudiated by the state legislature as “unjust” and “founded in ill policy.”<sup>215</sup> When Thomas Hutchinson sought the passage of a riot act in 1770, the Massachusetts House of Representatives replied that it would not legislate “without an apparent and very urgent Necessity” because a riot act would give magistrates “a Power that would be dangerous to the Rights and Liberties of the People.”<sup>216</sup>

Eventually, Hutchinson and other loyalists concluded that it would require legislation by Parliament to outlaw collective action.<sup>217</sup> The end result was, as we have seen, the Massachusetts Government Act of 1774, in response to which the First Continental Congress declared the right “peaceably to assemble”—language now found in the first amendment.<sup>218</sup> One month later, when Hutchinson charged that a Boston meeting called to organize resistance to the tea duty was unlawful, Samuel Adams had a ready reply—that a free people had a right to meet and consult.<sup>219</sup>

<sup>213</sup> See, e.g., Massachusetts Riot Act of 1750, *supra* note 204 (3 years); Pennsylvania Riot Act of 1764, *supra* note 204 (1 year from publication and then to the end of the next sitting assembly). The one exception was the oldest of the lot, the Connecticut Riot Act of 1722. See *infra* note 215.

<sup>214</sup> See C. BRIDENBAUGH, *supra* note 191, at 117 (noting that the Massachusetts Riot Act “did not go down well with the bulk of Bostonians”).

<sup>215</sup> Although the law had expired several years before, the legislature acted to remove any doubt as to whether prosecutions could be brought based on incidents prior to its expiration. See Acts 1778, ch. 11, *reprinted in* 1 LAWS OF THE STATE OF NEW YORK 20 (1886). Connecticut, on the other hand, continued its uniquely conservative course by reaffirming its law in 1776. See 15 THE PUBLIC RECORDS OF THE COLONY OF CONNECTICUT 283 (C. Hoadly ed. 1890).

<sup>216</sup> JOURNALS OF THE HOUSE OF REPRESENTATIVES OF MASSACHUSETTS 1770, at 178 (1977). Instead of suppressing the rioters, the House recommended redressing their grievances, claiming that it “may justly be said of the People of this Province, that they seldom if ever have assembled in a tumultuous Manner, unless they have been oppressed.” *Id.*

<sup>217</sup> See B. BAILYN, *supra* note 198, at 133; P. MAIER, *supra* note 167, at 133.

<sup>218</sup> See *supra* notes 184-87 and accompanying text.

<sup>219</sup> See Upton, *Proceedings of ye Body respecting the Tea*, 22 WM. & MARY Q. 287, 292-93 (1965).

## C. Peaceable Assembly as a Form of Popular Sovereignty

We have seen how the right of assembly was initially asserted to justify exercises of popular power. Through modern eyes, it is easy to see how marches, rallies, and nonimportation campaigns could be defended as forms of nonviolent political action. Like the boycotters in *NAACP v. Claiborne Hardware Co.*,<sup>220</sup> the American founders sought to change what they perceived to be an unjust and unresponsive political system. But there was a more radical dimension to the colonials' exercise of the right. Not only did they develop the notion of actual popular sovereignty—perhaps their greatest innovation in political theory<sup>221</sup>—but at least initially they took it literally.

Many, if not most, of the meetings called to organize opposition to British policies claimed to speak not only for those present, but also for the entire people of the town or district. Town meetings, the basic units of local government, provided the main organizational form for the movement in New England. To ensure that the whole people was represented, the normal property qualifications for attendance were often suspended. Towns outside New England, which were not formally organized on the town meeting model, emulated the New England example by calling meetings of the whole people.<sup>222</sup> When it was necessary to coordinate action at the county level, local meetings selected and sent delegates to extralegal county and province "conventions."<sup>223</sup>

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<sup>220</sup> 458 U.S. 886 (1982). This and other boycott cases are discussed *infra* notes 289-335 and accompanying text.

<sup>221</sup> On the radical significance of this advance, see G. WOOD, *supra* note 29, at 382-84; Amar, *Of Sovereignty and Federalism*, 96 YALE L.J. 1425, 1432-37 (1987).

<sup>222</sup> See B. LABAREE, *THE BOSTON TEA PARTY* 98-99 (1964); P. MAIER, *supra* note 167, at 118.

<sup>223</sup> The term "convention" already had a long and diverse history, but in all contexts it referred to a body which met "to exercise or influence power outside the established structure of government." *THE POPULAR SOURCES OF POLITICAL AUTHORITY: DOCUMENTS ON THE MASSACHUSETTS CONSTITUTION OF 1780*, at 5 (O. Handlin & M. Handlin eds. 1966) [hereinafter *POPULAR SOURCES*]; G. WOOD, *supra* note 29, at 306-10. Despite their use of delegates, these conventions qualify as exercises of "direct" popular power because they operated outside the structure of representative government in close contact with the popular movements that spawned them. Delegates were selected at a popular assembly, charged with specified missions, and dispatched to a single convention after which they were expected to report back to their constituents. For an analysis of the democratic advantages of the convention form, see Amar, *supra* note 221, at 1459 n.147; see also G. WOOD, *supra* note 29, at 323-24; *infra* notes 234-35 and accompanying text.

To the British and their supporters, these assemblies were patently illegal. While the people had a right to participate in government, once they had "chosen their representatives, that right [centered] in their *Representatives alone*."<sup>224</sup> It was true that the people of Massachusetts had been authorized to hold town meetings, but that had been "an absurdity" that had the effect of empowering "the lowest and most violent of the mob."<sup>225</sup> Parliament, in the Massachusetts Government Act, banned town meetings precisely to eliminate this exercise of direct democracy. By forcing the citizenry to cede power to town officials, Pownall sought to ensure that "the wise and prudent may act and govern."<sup>226</sup> Lord Germain expected to "see some subordination, some authority and order."<sup>227</sup>

At first, the Americans were careful to explain that their extra-legal assemblies were "loyal and dutiful" supplements to established government.<sup>228</sup> But as British authority crumbled and the revolutionary movement gained momentum, popular assemblies gradually displaced the colonial administration, performing such traditional government functions as regulating the economy, levying taxes, and disposing of the militia.<sup>229</sup> When North Carolina's provincial assembly openly took up the reins of government, it explained that the people had a right to assemble and petition the King.<sup>230</sup> Even after state power had shifted to Congress and the Revolutionary state legislatures, informal popular assemblies continued to be justified, as Samuel Adams asserted in 1777, by the people's right "to assemble upon all occasions to consult measures for promoting liberty and happiness."<sup>231</sup>

#### D. Peaceable Assembly During the Confederation Period

The defeat of Britain did not bring an end to popular assemblies. On the contrary, so many associations, conventions, and

<sup>224</sup> G. WOOD, *supra* note 29, at 314 (quoting a Tory tract).

<sup>225</sup> PROCEEDINGS AND DEBATES OF THE BRITISH PARLIAMENTS RESPECTING NORTH AMERICA 1754-1783, at 149 (R. Simmons & P. Thomas eds. 1985) (Pownall); *see also id.* at 151-52 (Lord North); *id.* at 279-80 (statement of Mr. R. Rigby).

<sup>226</sup> *Id.* at 149 (Pownall).

<sup>227</sup> *Id.* at 151 (Lord Germain).

<sup>228</sup> *See* Journal of Stamp Act Congress, *reprinted in* C. WESLAGER, THE STAMP ACT CONGRESS 181, 202 (1976); *see also* G. WOOD, *supra* note 29, at 312.

<sup>229</sup> *See* G. WOOD, *supra* note 29, at 321-22.

<sup>230</sup> *See* W. POWELL, NORTH CAROLINA THROUGH FOUR CENTURIES 173 (1989).

<sup>231</sup> G. WOOD, *supra* note 29, at 324.

assemblies sprang up that it seemed to some observers that the country would "shortly be overrun by committees."<sup>232</sup>

The most significant turmoil occurred in New England, where farmers, caught in the transition from subsistence to commercial farming, sought debt relief from their state governments. When none was forthcoming, they organized county conventions throughout the region.<sup>233</sup> Remote towns that could not afford to send a representative to the state capital "to wait six weeks or more on the Governor's pleasure" had no trouble sending delegates to the county convention.<sup>234</sup> In addition, conventions, unlike state legislatures, imposed no property qualifications for serving—a matter of great concern to towns that, as a result of the economic troubles, had not a single citizen who could meet the qualification for election to the legislature.<sup>235</sup> Like their revolutionary predecessors, these conventions passed resolutions, petitioned the legislature, and sometimes claimed sovereign powers.<sup>236</sup>

There was a lively debate over the conventions' legality. As an opening formality, the typical convention voted itself "constitutional" and renounced the use of violence.<sup>237</sup> This did not stop opponents from arguing that although conventions had been appropriate to challenge British power a decade earlier, they could not be justified now that "we have a constitution of our own choosing" that provided for the annual election of representatives.<sup>238</sup> To some, conventions could be lawful only if they met

<sup>232</sup> *Id.* at 326 (quoting a contemporary observer); see also *id.* at 323-28.

<sup>233</sup> See D. SZATMARY, *SHAYS' REBELLION: THE MAKING OF AN AGRARIAN INSURRECTION* 38-40 (1980).

<sup>234</sup> M. STARKEY, *A LITTLE REBELLION* 11 (1955); see also Pole, *Shays's Rebellion: A Political Interpretation*, in *THE REINTERPRETATION OF THE AMERICAN REVOLUTION 1763-1789*, at 419-20, 424-25 (J. Greene ed. 1968).

<sup>235</sup> See POPULAR SOURCES, *supra* note 223, at 35-39; M. STARKEY, *supra* note 234, at 11.

<sup>236</sup> See V. HALL, *POLITICS WITHOUT PARTIES* 204, 209 (1972); D. SZATMARY, *supra* note 233, at 39-40. For a contemporary account, see G. MINOT, *THE HISTORY OF THE INSURRECTIONS IN MASSACHUSETTS* 24-42 (1788) (2d ed. 1810).

<sup>237</sup> See R. Feer, *Shays' Rebellion 177* (Ph.D. thesis, Harvard Univ. 1958); see also G. MINOT, *supra* note 236, at 33-37 (describing the proceeding of a convention); M. STARKEY, *supra* note 234, at 13 (same). In this, the conventions followed the practice of the earlier nonimportation associations. See *supra* note 194 and accompanying text.

<sup>238</sup> See R. Feer, *supra* note 237, at 91 (quoting a statement of the Boston Town Meeting, Apr. 5, 1784); see also R. TAYLOR, *WESTERN MASSACHUSETTS IN THE REVOLUTION* 63, 141 (1954); G. WOOD, *supra* note 29, at 327. Similar arguments had been made during the convention movement leading up to the enactment of the Massachusetts Constitution of 1780. See *Response of the Worcester Committee of Correspondence, Oct. 8, 1778*, in POPULAR SOURCES, *supra* note 223, at 369, 372.



the test for the right of resistance, that government power had "been evidently and notoriously applied to unconstitutional purposes, and no constitutional means of redress" remained.<sup>239</sup>

The farmers turned to the Massachusetts Constitution of 1780, which guaranteed the right of the people "in an orderly and peaceable manner, to assemble to consult upon the common good" and to petition the legislature for redress of grievances.<sup>240</sup> Since the constitution did not prohibit conventions, it was argued, they must be encompassed under the right of assembly.<sup>241</sup> Convention supporters recalled the Revolutionary conventions of the 1770s and argued that the need for the people to assemble outside of the formal government remained as urgent under the new republic as it had been under British rule.<sup>242</sup>

In the end, no attempt was made to prohibit the conventions. Beginning in August 1786, the farmers rendered the issue moot by employing tactics that could be justified only under the right of resistance. In what became known as "Shays' Rebellion," armed crowds surrounded and occupied courthouses in numerous rural towns.<sup>243</sup> Nearly one thousand insurgents marched through Springfield behind fifes and drums, threatening warfare if the court did not adjourn.<sup>244</sup> In late fall, the Massachusetts legislature passed a riot act<sup>245</sup> and suspended habeas corpus.<sup>246</sup> Virginia and Vermont, which had also suffered turbulence, followed suit.<sup>247</sup>

<sup>239</sup> R. Feer, *supra* note 237, at 91-92 (quoting a statement of the Cambridge Town Meeting, July 24, 1786).

<sup>240</sup> MASS. CONST. of 1780, art. 19, *reprinted in* POPULAR SOURCES, *supra* note 223, at 441.

<sup>241</sup> See D. SZATMARY, *supra* note 233, at 39-40; R. Feer, *supra* note 237, at 90 (citing contemporary periodicals). In his contemporary account, George Richards Minot stated simply that the conventions were founded on the Massachusetts Constitution's guarantee of the right of assembly. See G. MINOT, *supra* note 236, at 24.

<sup>242</sup> See G. WOOD, *supra* note 29, at 326; R. Feer, *supra* note 237, at 90.

<sup>243</sup> The most detailed account is in R. Feer, *supra* note 237, at 180-210, 236-37.

<sup>244</sup> See *id.* at 229-32.

<sup>245</sup> See An Act to prevent Routs, Riots, and tumultuous Assemblies, and the evil Consequences thereof, Acts 1786, ch. 8. This law prohibited "any persons to the number of twelve, or more, being armed with clubs, or other weapons; or . . . any number of persons, consisting of thirty or more" from remaining "unlawfully, routously, riotously or tumultuously assembled" more than one hour after the reading of the riot act. *Id.* Unlike most of its colonial predecessors, this law had no termination date.

<sup>246</sup> See 1786 Acts, ch. 41, Nov. 10, 1786. This law expired by its own terms on July 1, 1787.

<sup>247</sup> See Vermont Riot Act of 1787, *reprinted in* 14 STATE PAPERS OF VERMONT:

E. *The Constitution and the Reestablishment of Politics-as-Normal*

The popular assemblies and the disorders of the Confederation period exerted a profound influence on the movement for a constitution. Far from celebrating direct democracy, many erstwhile revolutionaries feared that the people had become "the ready instruments of their own ruin."<sup>248</sup> Even Samuel Adams decided that "popular Committees and County Conventions are not only useless but dangerous."<sup>249</sup> Shays' Rebellion convinced many people that the Confederation had failed and it was time for strong national government.<sup>250</sup> George Washington credited the rebellion with shocking the states into sending delegates to the constitutional convention at Philadelphia.<sup>251</sup>

The Constitutionalists' solution was to erect a strong structure for politics-as-normal. While taking a bow to the right of resistance,<sup>252</sup> *The Federalist* portrayed popular assemblies as "frequently subject to the impulses of rage, resentment, jealousy, avarice, and of other irregular and violent propensities."<sup>253</sup> The distinctive feature of American government was to be "the total exclusion of the people, in their collective capacity" from the government.<sup>254</sup> Instead of directly participating, the people would delegate power to "a chosen body of citizens" who possessed more wisdom and less inclination toward passion and interest than ordinary citizens.<sup>255</sup> All that remained of the popular republican politics which had brought about the Constitution was an echo in article V authorizing

LAWS OF VERMONT 265-66, 281-84 (J. Williams ed. 1966); Virginia Riot Act of 1786, reprinted in 2 JEFFERSON PAPERS, *supra* note 2, at 517-19.

<sup>248</sup> G. WOOD, *supra* note 29, at 397.

<sup>249</sup> *Id.* at 327.

<sup>250</sup> See D. SZATMARY, *supra* note 233, at 123-28.

<sup>251</sup> See *id.* at 127.

<sup>252</sup> See *supra* note 169.

<sup>253</sup> THE FEDERALIST NO. 6, *supra* note 5, at 56 (A. Hamilton). Similarly, in response to Jefferson's suggestion that the people should be consulted directly in the event of a conflict between the branches of government, Madison warned against "disturbing the public tranquillity by interesting too strongly the public passions." THE FEDERALIST NO. 49, *supra* note 5, at 315 (J. Madison).

<sup>254</sup> THE FEDERALIST NO. 63, *supra* note 5, at 387 (A. Hamilton or J. Madison) (emphasis omitted).

<sup>255</sup> See THE FEDERALIST NO. 10, *supra* note 5, at 82 (J. Madison). For a well-documented portrayal of the debate between federalists and anti-federalists as a clash between aristocracy and democracy, see G. WOOD, *supra* note 29, at 512-16. On the purportedly superior civic virtue of representatives as opposed to ordinary citizens, see Sunstein, *Interest Groups*, *supra* note 20, at 43-45.

Congress to call constitutional conventions, but only upon application by two thirds of the state legislatures.<sup>256</sup>

### F. *Republican Moments and the Bill of Rights*

Given that the Bill of Rights was, in a sense, the "legacy of the anti-federalists," it would be odd to interpret the first amendment as a mere extension of the political theory embodied in *The Federalist*.<sup>257</sup> Yet this is precisely what liberal pluralist theory proposes to do.<sup>258</sup> The more natural view—that the amendment reflects the outlook of the anti-federalists and other strong proponents of a bill of rights—corresponds better to the legislative history.

During the ratification debates, the anti-federalists repeatedly urged the virtues of a small republic.<sup>259</sup> Backcountry anti-federalists feared a powerful national government that could not be controlled by town meetings or extra-legal county conventions.<sup>260</sup> But direct democracy was not a viable alternative. Given that even

<sup>256</sup> See U.S. CONST. art. V. Bruce Ackerman's use of article V to build a theory of periodic constitutional revision through popular republican politics is discussed *supra* notes 73-80 and accompanying text.

<sup>257</sup> See H. STORING, *WHAT THE ANTI-FEDERALISTS WERE FOR* 65 (1981); see also L. LEVY, *EMERGENCE OF A FREE PRESS* 221-22 (1985) (arguing that the anti-federalists merely used the Bill of Rights as a tactical pawn in their struggle to preserve state autonomy). While it is true that the Bill of Rights played a distinctly secondary role in anti-federalist thought, see *infra* notes 260-62 and accompanying text, it does not follow that anti-federalist thinking is unhelpful in determining the original meaning of the right of assembly. As Akhil Amar has shown, the Bill of Rights was "significantly more influenced by AntiFederalist thought than was 'Madison's original constitution.'" Amar, *The Bill of Rights as a Constitution* (forthcoming 100 YALE L.J. (1991)).

In particular, when it was necessary, the anti-federalists were willing to fight for rights of popular control over representative government. Although they spoke up in support of the right of assembly, the lack of any serious challenge obviated the need for passionate debate. On the question of a right to instruct representatives, on the other hand, the anti-federalists forced one of the most hotly contested debates on any proposed provision of the Bill of Rights. See 1 *ANNALS OF CONG.* 761-76 (J. Gales ed. 1834) [hereinafter *ANNALS* (J. Gales ed. 1834)]; see also *infra* text accompanying notes 267-70.

<sup>258</sup> John Ely, for example, finds liberal pluralist political theory in *The Federalist*, and then goes on to apply the theory to the Bill of Rights. See J. ELY, *supra* note 8, at 80, 89-104. His conclusion is that the appropriate role for constitutional jurisprudence is "policing the process of representation." *Id.* at 73-88.

<sup>259</sup> See H. STORING, *supra* note 257, at 15-23.

<sup>260</sup> See V. HALL, *supra* note 236, at 281-82. In the view of some anti-federalists, the federalist fear of popular assemblies was a symptom of aristocratic pretensions. See 3 *THE COMPLETE ANTI-FEDERALIST* 94-97 (H. Storing ed. 1981) (An Officer of the Late Continental Army).

the states were too large for a committee of the whole people, representative government was inevitable. Hence, the anti-federalists reluctantly conceded the inadequacy of direct popular government and focused their efforts on trying to keep power centered in the states, where representatives would be relatively responsive to the people,<sup>261</sup> and secondarily on constraining the national government with a Bill of Rights.

Although they failed to incorporate direct democracy into the institutional structure of politics-as-normal, the anti-federalists did join with others to preserve the right that had been invoked to justify extra-legal forms of popular power during the Revolutionary era. A number of states sent proposed amendments to the first Congress along with their ratifications of the Constitution. Four included the right peaceably to assemble.<sup>262</sup>

In the congressional debates, two views of the clause may be distinguished: one weak and one strong. Theodore Sedgwick, a conservative federalist from Massachusetts, put forth the weak view in support of his motion to delete the clause. "If people freely converse together," he argued, "they must assemble for that purpose." Hence, the assembly clause was nothing more than a redundant appendage to the free speech guarantee; indeed, it would be "derogatory to the dignity of the House to descend to such minutiae."<sup>263</sup> John Vining of Delaware embraced the weak conception, but turned it against Sedgwick, pointing out that "if the thing was harmless" and some states strongly desired it, then he might as well support it.<sup>264</sup>

Four congressmen rejected Sedgwick's "trivial" view of the clause, but failed to articulate a clear alternative.<sup>265</sup> Only El-

<sup>261</sup> See H. STORING, *supra* note 257, at 17. To the anti-federalists, national representatives would be "too far removed from the people, in general, to sympathize with them, and too few to communicate with them." 2 THE COMPLETE ANTI-FEDERALIST, *supra* note 260, at 268 (The Federal Farmer). As a result, the representatives would circulate among and sympathize with only the "natural aristocracy" and the "popular demagogues," but not with the "substantial and respectable part of the democracy." *Id.* at 269, 275-76; see also *id.* at 369 (Brutus) (observing that "in a large extended country, it is impossible to have a representation, possessing the sentiments, and of integrity, to declare the minds of the people . . .").

<sup>262</sup> These states were Virginia, North Carolina, New York, and Rhode Island. See Jarrett & Mund, *The Right of Assembly*, 9 N.Y.U. L.Q. REV. 1, 11 (1931). In addition, the right was included in a minority report from the Maryland convention. See B. SCHWARTZ, *supra* note 185, at 157.

<sup>263</sup> 1 ANNALS (J. Gales ed. 1834), *supra* note 257, at 759.

<sup>264</sup> *Id.* at 732.

<sup>265</sup> In John Page's view, the right was essential to the preservation of the other

bridge Gerry, a Massachusetts anti-federalist, attempted to provide a context. Although this "essential" right had been abused during Shays' Rebellion, he argued, the "people ought to be secure in the peaceable enjoyment of this privilege."<sup>266</sup>

The most illuminating statement, however, came in the debate over a proposed clause that would have given the people the right "to instruct their representatives."<sup>267</sup> Like the right of assembly, instruction was favored by the anti-federalists, who viewed both as means of increasing the people's role in government. Although successful on the assembly clause by a considerable majority, the anti-federalists were defeated on instruction by a vote of 41-10.<sup>268</sup> James Jackson of Georgia, one of the swing votes, explained that he was in favor of the right to assemble because "it had been used in this country as one of the best checks on the British Legislature in their unjustifiable attempts to tax the colonies."<sup>269</sup> The right to instruct, on the other hand, would bind the representatives, thus promoting factionalism and preventing the representatives from exercising their individual consciences.<sup>270</sup>

Jackson's statement suggests that the right of assembly should be viewed as incorporating a direct, popular supplement to strong representative government. The Constitution had shifted power from the local and state levels, where the people had been directly and passionately involved, to the national level, where cool-headed and public-minded representatives would practice sound government.<sup>271</sup> Jackson embraced this design, but only as a plan for

first amendment rights; "[i]f the people could be deprived of the power of assembling," then they "might be deprived of every other privilege contained in the clause." *Id.* at 760. Thomas Tucker and Thomas Hartley added vaguely that the clause was "of importance" and "as necessary to be inserted . . . as most in the clause." *Id.* at 760-61.

<sup>266</sup> *Id.* at 760. This statement corresponded to Gerry's views on the rebellion. While most Massachusetts leaders reacted to the convention movement with alarm, he remained cool and opposed repression until long after the Shaysites had turned from peaceful county conventions to armed attacks on the courts. See G. BILLIAS, *ELBRIDGE GERRY, FOUNDING FATHER AND REPUBLICAN STATESMAN* 150-51 (1976).

<sup>267</sup> 1 ANNALS (J. Gales ed. 1834), *supra* note 257, at 761. Instruction was a common practice during the Revolutionary and Confederation periods. Town meetings or county conventions would instruct their representatives how to vote in the state legislature. For the representatives to vote otherwise was considered defiance of popular sovereignty. See G. WOOD, *supra* note 29, at 189-90.

<sup>268</sup> See 1 ANNALS (J. Gales ed. 1834), *supra* note 257, at 776.

<sup>269</sup> *Id.* at 764.

<sup>270</sup> See *id.*

<sup>271</sup> See *supra* text accompanying notes 252-56. See generally Sunstein, *Constitutionalism*, *supra* note 20, at 430-37 (discussing Madison's belief that representatives

politics-as-normal. With Madison, he opposed the right to instruct because direct popular control over representatives would negate their individual judgment and remove any possibility of deliberating toward a unified view.<sup>272</sup> But Jackson could not agree to "the total exclusion of the people, in their collective capacity" from the government.<sup>273</sup> As the reference to the tax resistance makes clear, he saw the right of assembly as a protection for forceful, collectively organized, and direct popular pressure.

This strong reading appears to be the natural one. Sedgwick's weak reading is implausible given the historical proximity of strong usage by the American resistance movement and the Shaysites.<sup>274</sup> Indeed, the right had been invoked almost exclusively to justify exercises of popular power; there was no need to defend meetings called merely to discuss issues or advocate viewpoints.<sup>275</sup> As Jackson's and Gerry's remarks indicate, these events were on the minds of the framers. Their apparent conclusion was that the value of the people assembled as a check on representative government justified a degree of political instability and the risk of violent abuses.

could independently achieve the public good).

<sup>272</sup> Jackson argued that the right of instruction "would necessarily drive the house into a number of factions. There might be different instructions from every State, and the representation from each State would be a faction to support its own measures." 1 ANNALS (J. Gales ed. 1834), *supra* note 257, at 764. Madison emphasized the importance of the congressman's individual judgment: "Suppose he is instructed to patronize certain measures, and from circumstances known to him, but not to his constituents, he is convinced that they will endanger the public good; is he obliged to sacrifice his own judgment to them?" *Id.* at 767.

<sup>273</sup> See THE FEDERALIST NO. 63, *supra* note 5, at 387 (A. Hamilton or J. Madison) (emphasis omitted).

<sup>274</sup> One wonders whether Sedgwick's insistence on a narrow reading might have masked a concern that the clause would in fact be read more broadly. Only a few years before, he had been a leader of the movement to suppress Shays' Rebellion. In the course of the conflict, his home was looted on one occasion and on another he was briefly captured. See R. WELCH, THEODORE SEDGWICK, FEDERALIST: A POLITICAL PORTRAIT 48-52 (1965). Unlike most of the counterinsurgency leaders, he was a resident of western Massachusetts and thoroughly immersed in local politics. It seems improbable that he was unaware of the Shaysites' reliance on the right of peaceable assembly to justify their county conventions.

<sup>275</sup> No one was prosecuted or imprisoned merely for meeting or petitioning. The right to assemble was called upon to justify provincial and continental congresses, unauthorized assemblies of colonial legislators, nonimportation assemblies, and extra-legal county conventions. See J. REID, *supra* note 186, at 17-18.

## V. DIRECT POPULAR POWER AND THE FIRST AMENDMENT

In Parts III and IV of this Article, I argued that republican moments provide a vital supplement to representative politics-as-normal. If this is true, then the vague guarantees of the first amendment should be purposively construed to protect exercises of direct popular power that carry out this supplementary role.

A. *The First Amendment Value of Direct Popular Power*

It is certainly possible to argue for rights of forceful protest without drawing on popular republican theory or referring to republican moments. From a liberal pluralist perspective, it can be argued that protest is essential for groups effectively to advance their interests, or that protest enables less wealthy groups to offset the financial power of wealthier groups.

By themselves, however, these arguments have limited appeal. Why should judges force citizens to bear the costs and endure the disruptions of protest merely to give special interest groups fair and equal access to the public trough?<sup>276</sup> If fairness is the problem, then why not mandate judges to overturn unfairly enacted legislation or, less drastically, construe statutes in favor of disadvantaged groups?<sup>277</sup>

The answer—and it comes as no surprise at this point in the essay—is that the American constitutional order both requires and embodies a popular republican supplement to remedy the corruption and political degeneration of interest group bargaining. In order to break through the apathy and selfishness of politics-as-normal, social movements often find it necessary to employ forms of protest that are experienced by their targets as coercive. It is not easy to divert citizens from private pursuits or politicians and administrators from the cozy routine of interest group bargaining. When disempowered groups try to “enter the conversation,” as

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<sup>276</sup> Once an issue has been reduced to a clash of private interests, judges are not likely to impose costs on “innocent” third parties to assist one side or the other. For a brilliant treatment of this problem in the context of affirmative action, see Ansley, *Stirring the Ashes: Race, Class and the Future of Civil Rights Scholarship*, 74 CORNELL L. REV. 993 (1989).

<sup>277</sup> In asking this rhetorical question, I do not mean to suggest that these proposals would be unwise if implemented in addition to rather than as a substitute for protection for forceful protest. See, e.g., Eskridge, *supra* note 20, at 1032 (arguing that statutes “affecting certain discrete and insular minorities” should be interpreted, “where possible, for the benefit of those minorities”).

Michelman points out, "we" may sometimes feel that they "seek to disrupt it."<sup>278</sup> Higher track lawmaking necessarily involves "passion, debate and conflict."<sup>279</sup> If the public life is to present a viable alternative to private pursuits, it must encompass "not only communication, but the development and exercise of power, the power to create new forms as well as the strength to resist existing structures."<sup>280</sup>

The republican value of direct popular power adds a factor to be weighed in first amendment balancing. Consider, for example, the recent residential picketing case, *Frisby v. Schultz*.<sup>281</sup> In *Frisby*, antiabortion activists peacefully picketed the home of a doctor who performed abortions at nearby medical clinics. The Court upheld an ordinance that, as judicially narrowed, barred "focused picketing taking place solely in front of a particular residence."<sup>282</sup>

It is difficult to avoid the conclusion that the majority simply identified with the homeowner's desire for privacy, while showing no interest in the function of the picketing as a form of moral discourse. According to the majority opinion, the picketing "inherently and offensively" intruded on residential privacy with "devastating" consequences. Even a lone picketer could "invade" privacy, as few of "us" would feel comfortable with a stranger who "lurks" outside.<sup>283</sup>

Meanwhile, the Court had little to say about the value or function of residential picketing, other than to characterize it as "narrowly directed at the household," and thus not implicating the constitutional value of public communication.<sup>284</sup> Justice Stevens in his dissent went further, suggesting that repeated picketing would serve no purpose except "to harm the doctor and his family."<sup>285</sup>

These statements betray a lack of sensitivity to the role of picketing in the activists' effort. Even if the protesters aimed solely to stop the doctor from performing abortions, they undoubtedly expected that unwanted notoriety among his neighbors would help

<sup>278</sup> Michelman, *supra* note 58, at 1529.

<sup>279</sup> Ackerman, *supra* note 73, at 1072.

<sup>280</sup> C.E. BAKER, *supra* note 161, at 117-18; see also *supra* text accompanying notes 39-42.

<sup>281</sup> 487 U.S. 474 (1988).

<sup>282</sup> *Id.* at 483.

<sup>283</sup> *Id.* at 486-87 (quoting *Carey v. Brown*, 447 U.S. 455, 478-79 (1980) (Rehnquist, J., dissenting)).

<sup>284</sup> See *id.* at 486.

<sup>285</sup> *Id.* at 498 (Stevens, J., dissenting).



accomplish their end. By removing the shield of anonymity, they transformed what might otherwise have been a private career decision into a public moral issue. Ever since colonial tax resisters held rallies at the homes of British sympathizers, residential protest has served this function.<sup>286</sup>

While it is true that the picketers were exhibiting hostility toward the doctor, it is also true that they were treating him as a member of a moral community. Instead of writing him off, they evidently felt that an hour or two of picketing every week might be enough to induce him to cease performing abortions.<sup>287</sup> This hope would not, of course, be fulfilled if the doctor was strongly committed to keeping abortion available. Whatever the outcome, the picketers were, by their act of moral commitment, testing his. Although the test might be devastating to the Supreme Court's "us," it was also an entirely nonviolent means of injecting moral passion into public political discourse, an essential step on the road to a republican moment.<sup>288</sup>

#### B. *The Value of Direct Popular Power Embodied in Current Doctrine: The Constitutional Right to Boycott*

While ignoring the republican function of direct popular power in *Frisby*, the Supreme Court has nevertheless placed it at the core of the first amendment doctrine governing boycotts. The resulting case law provides the most fully developed example of the Court's approach toward direct popular power.

##### 1. Background: *Claiborne Hardware* and *SCTLA*

Eight years ago, in *NAACP v. Claiborne Hardware Co.*,<sup>289</sup> the Supreme Court addressed the constitutionality of a state tort judgment against black citizens who had conducted a boycott of

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<sup>286</sup> See, e.g., P. MAIER, *supra* note 167, at 127-28 (describing the practice of mass meetings outside the homes of merchants to dissuade them from importing British goods).

<sup>287</sup> The doctor's home was picketed "on at least six occasions between April 20, 1985, and May 20, 1985, for periods ranging from one to one and a half hours." *Frisby*, 487 U.S. at 476.

<sup>288</sup> It should be remembered that the Court was upholding a flat ban on residential picketing. Limits on the number or intrusiveness of pickets would pose a more difficult case even considering the picketing's functions in higher lawmaking.

<sup>289</sup> 458 U.S. 886 (1982).

white businesses in Port Gibson, Mississippi. The boycott was a classic instance of popular republican politics.

The local branch of the NAACP had petitioned the county government and private businesses, urging them to provide equal treatment for blacks.<sup>290</sup> When the response proved unsatisfactory, several hundred black citizens met at a church and voted unanimously to boycott white merchants.<sup>291</sup> Boycott supporters picketed white-owned stores and organized a group known as the "Deacons," or "Black Hats" to enforce the boycott.<sup>292</sup> Violators were publicly identified as "traitors" to the black community, socially ostracized, occasionally threatened with violence, and very occasionally physically attacked.<sup>293</sup>

The Supreme Court held that the first amendment protects peaceful civil rights boycott activities and overturned the tort judgment against the boycotters.<sup>294</sup> "Speech," said the Court, should "not lose its protected character . . . simply because it may embarrass others or coerce them into action."<sup>295</sup> Furthermore, although violence was "beyond the pale" of the Constitution, violent acts would not render a boycott unprotected unless the plaintiffs could meet the "heavy" burden of establishing that "fear rather than protected conduct was the dominant force in the movement."<sup>296</sup>

Last term, in *FTC v. Superior Court Trial Lawyers Association* ("SCTLA"),<sup>297</sup> the Court unanimously rejected a claim that *Claiborne Hardware* protected a concerted refusal by lawyers to serve as court-appointed defense counsel until their hourly fees were raised.<sup>298</sup> The Court distinguished *Claiborne Hardware* on grounds that closely parallel the definition of republican moments. While the civil rights boycotters "sought no special advantage for them-

<sup>290</sup> See *NAACP v. Claiborne Hardware Co.*, 393 So. 2d 1290, 1295-97 (Miss. 1980), *rev'd*, 458 U.S. 886 (1982).

<sup>291</sup> See *Claiborne Hardware*, 458 U.S. at 900.

<sup>292</sup> See *id.* at 903-04.

<sup>293</sup> At least four incidents of violence were connected to the boycott, including two involving shots fired into the homes of non-boycotters. See *id.* at 904. At a boycott rally, Charles Evers, the Field Secretary of the NAACP, reportedly threatened to break the neck of anyone caught violating the boycott. See *id.* at 902.

<sup>294</sup> See *id.* at 912-15, 934.

<sup>295</sup> *Id.* at 910; cf. *Organization for a Better Austin v. Keefe*, 402 U.S. 415, 419-20 (1971) (stating that "peaceful picketeering" is protected by the first amendment even where the pamphlet's message is "intended to exercise a coercive impact" on others).

<sup>296</sup> *Claiborne Hardware*, 458 U.S. at 933-34.

<sup>297</sup> 110 S. Ct. 768 (1990).

<sup>298</sup> See *id.* at 776-78; *id.* at 791-92 (Blackmun, J., concurring in part and dissenting in part); *id.* at 782 n.1 (Brennan, J., dissenting in part).

selves," the lawyers' "immediate objective was to increase the price that they would be paid for their services."<sup>299</sup> Unlike the lawyers, the NAACP was fighting to implement the constitutional ideal of equality, to obtain the "equal respect and equal treatment to which they were constitutionally entitled."<sup>300</sup> Their struggle transcended the day-to-day conduct of business as usual: "Equality and freedom are preconditions of the free market, and not commodities to be haggled over within it."<sup>301</sup>

## 2. The Right to Boycott as a Popular Republican Supplement to Representative Politics

From a liberal pluralist viewpoint, these distinctions make little sense. As we have seen, liberal pluralist theory is comfortable with the notion that politics consists of manipulating state power for private gain. Indeed, judicial discrimination between selfish and virtuous political activities conflicts with the liberal commitment to neutrality among speakers and viewpoints.<sup>302</sup>

Where politics-as-usual is concerned, the Court has not hesitated to carry this neutrality principle through to its logical conclusions. In *Eastern Rail Road Presidents Conference v. Noerr Motor Freight*,<sup>303</sup> for example, an association of railroads engaged in an anti-trucking publicity campaign aimed at securing the passage of legislation restricting the trucking industry, the railroads' major competition. The railroads were thus more obviously self-interested than the SCTL lawyers, who could plausibly claim to be concerned about the quality of representation for criminal defendants as well as their own pocketbooks. But the Court dismissed the railroads' motive as irrelevant.<sup>304</sup> In order to avoid "important constitutional ques-

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<sup>299</sup> *Id.* at 777.

<sup>300</sup> *Id.*

<sup>301</sup> *Id.*

<sup>302</sup> On this commitment, see J. ELY, *supra* note 8, at 105-34; Kalven, *The Metaphysics of the Law of Obscenity*, 1960 SUP. CT. REV. 1, 19; Karst, *Equality as a Central Principle in the First Amendment*, 43 U. CHI. L. REV. 20, 29-35 (1975).

<sup>303</sup> 365 U.S. 127 (1961).

<sup>304</sup> See *id.* at 138-40 (noting that "[i]t is neither unusual nor illegal for people to seek action on laws in the hope that they may bring about an advantage to themselves and a disadvantage to their competitors").

tions,"<sup>305</sup> it held that the Sherman Act did not prohibit the campaign.

The *SCTLA* Court distinguished *Noerr* exactly on the line between representative politics and direct popular power. While the alleged restraint of trade in *Noerr* "was the intended consequence of public action," the *SCTLA* boycott "would have had precisely the same anticompetitive consequences . . . even if no legislation had been enacted."<sup>306</sup> In other words, the railroads in *Noerr* were using the normal processes of representative government to obtain a legislative restraint on trade, while the *SCTLA* lawyers were directly exercising their collective economic power to fix prices.<sup>307</sup>

One might ask why this should make a difference. The answer depends on one's political viewpoint. From an elitist republican perspective, the vice of the *SCTLA* boycott was that it circumvented the Madisonian check on popular passions and interests. While the process of deliberation among purportedly virtuous representatives normally ensures that legislation serves public ends, the *SCTLA* lawyers bypassed this safeguard when they exerted direct economic pressure on the city.

From a liberal pluralist perspective, on the other hand, the outputs as well as the inputs of government may properly serve private purposes. Since judges cannot distinguish between private and public interests without improperly drawing on their own controversial value preferences, the best they can do is ensure that

<sup>305</sup> *Id.* at 137-38. *Noerr* was subsequently extended to protect access to administrative agencies and courts. See *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508, 510-11 (1972); *United Mine Workers v. Pennington*, 381 U.S. 657, 669-70 (1965). For an illuminating analysis of *Noerr* as an embodiment of interest group pluralism, see Minda, *supra* note 7, at 931-35.

<sup>306</sup> *SCTLA*, 110 S. Ct. at 776. At first glance, this reasoning would seem to overturn *Missouri v. National Org. for Women*, 620 F.2d 1301 (8th Cir.), *cert. denied*, 449 U.S. 842 (1980) (extending *Noerr* to protect a boycott of Missouri convention facilities in protest of the state legislature's failure to ratify the Equal Rights Amendment). More likely, however, the *NOW* decision—having served as part of the support for *Claiborne Hardware*, 458 U.S. at 914 n.48—will now be saved by that decision.

<sup>307</sup> For readers who have an integrated conception of political and economic life, it may be difficult to understand the Court's approach. The *SCTLA* lawyers were, like the *Noerr* railroads, seeking action from government. And the railroads were, like the lawyers, exerting economic power (by paying for a publicity barrage). But the railroads' publicity campaign would produce economic results only if the elected representatives were persuaded to legislate, while the lawyers could and did produce immediate economic results by collectively withholding their services.

conflict among interest groups is played out according to the rules of the game. In this view, the SCTLA abandoned its constitutional shield when it chose to exercise power outside the constitutionally-established process of representative government.

While both elitist republicanism and liberal pluralism can thus distinguish *Noerr* from SCTLA, neither can distinguish SCTLA from *Claiborne Hardware*. Like the lawyers in SCTLA, the civil rights boycotters in *Claiborne Hardware* exercised power directly, thus bypassing the filter of representative politics (be it an elitist republican filter of virtue operating on outcomes, or a liberal pluralist filter of fairness operating on process).

*Claiborne Hardware* thus appears to be a popular republican exception to the normal judicial preference for representative government.<sup>308</sup> Taken together, SCTLA and *Claiborne Hardware* hold that popular republican tactics are constitutionally protected, but only if they exhibit the virtues of popular republicanism: namely, the pursuit of interests broader than immediate pecuniary gain, and an appeal to fundamental ideals.<sup>309</sup>

This reconciliation aids in explaining the contrasting results in *Claiborne Hardware* and *International Longshoremen's Association v.*

<sup>308</sup> *Claiborne Hardware* could also be viewed as an extension of suspect classification analysis into the first amendment area. Since black Americans are unable effectively to participate in interest group bargaining, it follows that they should be permitted to use extraordinary, extra-institutional forms of political action. See H. KALVEN, *THE NEGRO AND THE FIRST AMENDMENT* 123-72 (1966); Cover, *The Origins of Judicial Activism in the Protection of Minorities*, 91 YALE L.J. 1287, 1311-12 (1982).

In its broad outline, this theory is not opposed to the vision of a popular republican supplement advocated here. It suggests that the first amendment protects the exercise of direct group power when necessary to remedy a malfunction in politics-as-normal. If limited to groups that are singled out for special protection under suspect classification analysis, however, it would provide inadequate protection. Republican moments are not just for discrete and insular minorities; indeed, virtually the entire people may participate, as in the struggle for independence. The theory would exclude the democratic reformers of the Jacksonian era, the populists of the late nineteenth century, and the trade unionists and unemployed activists of the 1930s.

The SCTLA Court may have had something like this theory in mind when it observed that the *Claiborne Hardware* boycotters were struggling "to change a social order that had consistently treated them as second class citizens." SCTLA, 110 S. Ct. at 777 (quoting *Claiborne Hardware*, 458 U.S. at 912). However, the Court's emphasis on the SCTLA boycotters' objective to benefit themselves economically, suggests that the Justices may not be anxious to adopt a theory that would require them to discriminate among social groups in the first amendment area. See SCTLA, 110 S. Ct. at 777-78.

<sup>309</sup> See *supra* text accompanying notes 33-38.

*Allied International* ("ILA"),<sup>310</sup> a problem that has attracted wide attention from commentators.<sup>311</sup> ILA involved a refusal by longshoremen to unload Soviet goods as a protest against the Soviet invasion of Afghanistan. As in *Claiborne Hardware*, the boycotters were pursuing a broad social goal rather than narrow self-interest.<sup>312</sup> But the ILA's boycott was not an exercise of popular republican politics. ILA president Thomas Gleason had "ordered ILA members to stop handling cargoes."<sup>313</sup> Far from engaging in an exercise of positive freedom, the longshoremen acted "[i]n obedience to" Gleason's order.<sup>314</sup> Given the long history of autocracy in the ILA, the coercive power Gleason held over individual workers, and the workers' inability to leave the union's jurisdiction without sacrificing their jobs,<sup>315</sup> the boycott could hardly be viewed as an exercise in democracy.

### 3. An Expansive Reading of the Right

That the theory of republican moments helps to *explain* the boycott decisions does not mean that it *supports* them. By attempting to tailor first amendment protection to virtuous protests, the

<sup>310</sup> 456 U.S. 212 (1982).

<sup>311</sup> See L. TRIBE, *supra* note 116, at 200-03; Getman, *Labor Law and Free Speech: The Curious Policy of Limited Expression*, 43 MD. L. REV. 4, 16-19 (1984); Harper, *The Consumer's Emerging Right to Boycott: NAACP v. Claiborne Hardware and its Implications for American Labor Law*, 93 YALE L.J. 409 (1984); Kupferberg, *Political Strikes, Labor Law, and Democratic Rights*, 71 VA. L. REV. 685 (1985); Pope, *The Three-Systems Ladder of First Amendment Values: Two Rungs and a Black Hole*, 11 HASTINGS CONST. L.Q. 189, 224-28 (1984); Note, *Peaceful Labor Picketing and the First Amendment*, 82 COLUM. L. REV. 1469, 1489 n.132 (1982); Note, *Labor Picketing and Commercial Speech: Free Enterprise Values in the Doctrine of Free Speech*, 91 YALE L.J. 938 (1982).

<sup>312</sup> The *Claiborne Hardware* decision distinguished ILA by making an apples-and-oranges contrast between the economic restrictions involved in that case with the political activity involved in *Claiborne*. See *Claiborne Hardware*, 458 U.S. at 912-13. However, *Claiborne Hardware* also involved economic restrictions, and ILA also involved political activity. See Pope, *supra* note 311, at 226-27.

<sup>313</sup> ILA, 456 U.S. at 214.

<sup>314</sup> See *id.* This factor figured in the decision of the First Circuit Court of Appeals denying first amendment protection to the boycott. See *Allied Int'l, Inc. v. International Longshoremen's Ass'n*, 640 F.2d 1368, 1379 n.11 (1st Cir. 1981), *aff'd*, 456 U.S. 212 (1982). For a penetrating constitutional analysis of the significance of Gleason's order, see Kupferberg, *supra* note 311, at 738-39.

<sup>315</sup> See generally PRESIDENT'S COMMISSION ON ORGANIZED CRIME, THE EDGE: ORGANIZED CRIME, BUSINESS AND LABOR UNIONS 33-70 (1986) (recounting control of racketeers over ILA and efforts to expose mob involvement); D. GODDARD, ALL FALL DOWN: ONE MAN AGAINST THE WATERFRONT MOB (1980) (same).

Court may have unduly constricted the space for popular republican politics. Even campaigns for the lofty goals of equality and freedom often focus on immediate economic gains, especially when the participants are economically disadvantaged. The "Don't Buy Where You Can't Work" boycotts of the 1930s and 1940s prefigured the more political boycotts of the 1950s and 1960s.<sup>316</sup> The *Claiborne Hardware* boycotters themselves were demanding more jobs for themselves and their families.<sup>317</sup> Even the colonial Whig nonimporters were seeking to reduce taxes and, in some cases, to destroy competitors who were dependent on British imports.<sup>318</sup>

There is also a suggestion in *SCTLA* that boycotters may be protected only when they are seeking to enforce rights that are already recognized by courts as constitutionally guaranteed.<sup>319</sup> Rights-creation, however, is one of the hallmarks of republican moments.<sup>320</sup> Whatever one may think about the concept of rights at the level of philosophy, there is no doubt that rights discourse has historically served as the primary point of connection between popular movements and constitutional jurisprudence.<sup>321</sup> In mass meetings as well as court proceedings, the labor movement advanced "labor's constitution," a vision of labor rights grounded in the first and thirteenth amendments, as an alternative to the jurisprudence of *Lochner* era judges.<sup>322</sup> The civil rights move-

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<sup>316</sup> Boycotts conducted by "Housewives Leagues" have been credited with winning 75,000 jobs for blacks during the depression. See J. JONES, *supra* note 142, at 215.

<sup>317</sup> The boycotters demanded that all of the targeted businesses hire black clerks and cashiers and that the county government hire black policemen, welfare workers, school staff, and hospital staff. See *NAACP v. Claiborne Hardware Co.*, 393 So. 2d 1290, 1296 (Miss. 1980), *rev'd*, 458 U.S. 886 (1982).

<sup>318</sup> See C. BRIDENBAUGH, *supra* note 191, at 281-82.

<sup>319</sup> See *supra* note 300 and accompanying text; see also *Claiborne Hardware*, 458 U.S. at 914 (stating that "[t]he right of the States to regulate economic activity could not justify a complete prohibition against a nonviolent, politically motivated boycott designed to force governmental and economic change and to effectuate rights guaranteed by the Constitution itself" (emphasis added)).

<sup>320</sup> In addition to the Bill of Rights, the right of otherwise qualified nonpropertied citizens to vote, the right to be free from chattel slavery and involuntary servitude, the right of workers to self-organization, and the right to be free from private race and sex discrimination are all among the rights that gained legal recognition during republican moments.

<sup>321</sup> See Hartog, *The Constitution of Aspiration and "The Rights That Belong To Us All,"* 74 J. AM. HIST. 1013, 1024 (1987) (noting that "[g]roups have been able to draw from constitutional language ways of demonstrating that those who exercised power over them did so illegitimately, immorally, and wrongly, and therefore had nothing worthy of recognition as vested rights").

<sup>322</sup> See Forbath, *supra* note 95, at 1208-14.

ment—through its leading spokesman, Martin Luther King, Jr.—likewise asserted its constitutional vision in opposition to the prevailing positive law.<sup>323</sup> If disempowered groups are to be heard in constitutional discourse, the courts must protect their struggles to create new rights as well as to enforce old ones.

The Court's use of noneconomic objectives and constitutional concerns as criteria for protection will involve judges in highly problematic judgments about the value of protests. Suppose the *Claiborne Hardware* boycotters had been demanding only that segregated employers hire blacks. Would their "economic" objective have rendered their protest unprotected?<sup>324</sup> What if a group with economic objectives, having read *SCTLA*, adds political demands to its economic demands? If a group claims, as unions and workers did in the 1930s, that it is fighting for its constitutional rights, should protection hinge on whether the group's view of the Constitution coincides with that of the judges? Should environmentalists be denied constitutional protection because their demands do not refer to any recognized constitutional right?<sup>325</sup>

If popular republican politics are to be given adequate space, judges will have to abandon the effort to limit protection to virtuous protests over fundamental issues. While popular republican theory provides the reasons for protecting such protests, it cannot provide criteria determinate enough to enable judges to distinguish them from other, less noble protests.<sup>326</sup> Judges cannot be expected to anticipate which social movements and which issues will eventually trigger full-scale republican moments. Demands that will later be recognized as political and fundamental may initially be

<sup>323</sup> See Kennedy, *supra* note 120, at 1000-02.

<sup>324</sup> Compare *Hughes v. Superior Court*, 339 U.S. 460 (1950) (holding that an injunction against picketers who were demanding that blacks be hired in proportion to their population in the area was justified by the state's policy against picketing to force discriminatory hiring on a racial basis) with *Kirkland v. Wallace*, 403 F.2d 413 (5th Cir. 1968) (treating picketing in support of demands for black hiring as constitutionally protected and striking down an anti-boycott statute as facially invalid).

<sup>325</sup> Cf. *Environmental Planning & Information Council v. Superior Court*, 36 Cal. 3d 188, 197, 680 P.2d 1086, 1092, 203 Cal. Rptr. 127, 133 (1984) (holding that a secondary boycott by environmentalists against private businesses was entitled to first amendment protection).

<sup>326</sup> Thus, in this case, the liberal principle of neutrality is best suited to protect republican values. As we have seen, there is no reason other than abstract consistency to be disturbed over convergences between liberal and republican theory. See *supra* note 38. For a thoughtful argument that judges can and should make content-based distinctions between communicative activities that do and those that do not contribute to republican deliberation, see Minda, *supra* note 7, at 1001-08.



seen as narrow, self-interested, and factional. Like most citizens, judges may feel skeptical about protesters' motivations and irritated at the disruptions they cause.<sup>327</sup> It can take a prolonged period of mass political action and education to change their minds. The Supreme Court, for example, was able to recognize the constitutional value of labor organizing and picketing only after the republican moment of the 1930s had been underway for years.<sup>328</sup> By that time, the Wagner Act had been passed and the decisive organizing victories won.<sup>329</sup> Although the Court did a better job of protecting civil rights protests, the most important decisions did not come until the republican moment of the 1960s was in full swing,<sup>330</sup> and the Court did not get around to protecting boycotts until *Claiborne Hardware* in 1982. During the crucial, early stages of both movements, when they were politically isolated and in desperate need of constitutional protection, courts not only denied protection but actively suppressed their protests.<sup>331</sup>

Although the *SCTLA* language on noneconomic and constitutional objectives suggests that these failings are likely to be repeated, the Court did supply a narrow interpretation of its holding. In response to the dissent, which emphasized the value of

<sup>327</sup> See *supra* text accompanying notes 122-23.

<sup>328</sup> The constitutional breakthroughs came in *Hague v. CIO*, 307 U.S. 496 (1939); *Thornhill v. Alabama*, 310 U.S. 88 (1940) and *Thomas v. Collins*, 323 U.S. 516 (1945).

On the shift in the judicial view of labor picketing from commercial to political and back again, see Pope, *Labor and the Constitution: From Abolition to Deindustrialization*, 65 TEX. L. REV. 1071, 1076-78, 1089-96 (1987).

<sup>329</sup> The Wagner Act was passed in 1935. The key union organizing victories were won against General Motors and "Big Steel" in 1936 and 1937. See generally I. BERNSTEIN, *TURBULENT YEARS, A HISTORY OF THE AMERICAN WORKER: 1933-1941* (1969).

<sup>330</sup> Cases involving the kind of militant protest tactics characteristic of republican moments included: *Garner v. Louisiana*, 368 U.S. 157 (1961) (reversing the convictions of sit-in protestors for disturbing the peace); *Edwards v. South Carolina*, 372 U.S. 229 (1963) (reversing the convictions of black demonstrators since there was no violence or threat of violence on their part or on the part of any member of the crowd watching them); and *Cox v. Louisiana*, 379 U.S. 536 (1965) (reversing the convictions of black protestors because the breach of peace statute was unconstitutionally vague and because the obstructing public passage statute was discriminatorily applied).

<sup>331</sup> Earlier decisions issuing or upholding injunctions against civil rights protesters include *Hughes v. Superior Court*, 339 U.S. 460 (1950) (described *supra* note 324); *Green v. Samuelson*, 168 Md. 421, 178 A. 109 (1935) (concerning an injunction against picketing to compel white merchants to hire blacks); and *A.S. Beck Shoe Corp. v. Johnson*, 153 Misc. 363, 274 N.Y.S. 946 (Sup. Ct. 1934) (same).

On the judicial suppression of labor protest, see Forbath, *supra* note 95, at 1148-55.

boycotting as a form of political communication,<sup>332</sup> the majority noted that "this case involves not only a boycott but also a horizontal price-fixing arrangement—a type of conspiracy that has been consistently analyzed as a *per se* violation [of the anti-trust laws] for many decades."<sup>333</sup> As the Court pointed out, this price-fixing element distinguishes the SCTLA boycott from those listed by the dissent, which included the colonial boycotts against the British, the Montgomery bus boycott, NOW's boycott in support of the ERA, the United Farm Workers' grape boycott, and a host of others.<sup>334</sup> If limited to price-fixing conspiracies, the holding of SCTLA would thus leave most popular republican boycotts protected.<sup>335</sup>

## VI. REPUBLICAN STATUTES

Republican moments invariably yield many laws. Some of these laws take the form of constitutional amendments or pathbreaking judicial opinions, a theme pursued by Bruce Ackerman in his recent contribution, *Constitutional Politics/Constitutional Law*.<sup>336</sup> Most, however, are statutes. The two most recent republican moments, the New Deal period and the 1960s, produced mainly statutes.

How should courts treat these legislative products of republican moments? Here, Ackerman's initial suggestions are disturbing. *The*

<sup>332</sup> See SCTLA, 110 S. Ct. at 788-90 (Brennan, J., dissenting).

<sup>333</sup> *Id.* at 782 n.19.

<sup>334</sup> See *id.* at 776-78, 782 n.19; *id.* at 788 (Brennan, J., dissenting).

<sup>335</sup> At least one important form of boycott would, however, be excluded. Strikes for higher wages played an important role in the republican moment of the 1930s. Wage demands often reflect concerns of justice and self-respect rather than a simple desire for "more." See, e.g., P. DRUCKER, *THE NEW SOCIETY: THE ANATOMY OF THE INDUSTRIAL ORDER* 76 (1950) (noting that conflict over wages is really a "mock conflict" designed to hide deeper concerns over issues of "power" and "citizenship").

<sup>336</sup> Ackerman, *Constitutional Politics/Constitutional Law*, 99 YALE L.J. 453 (1989). In that article, Ackerman takes a retrospective view of the three constitutional moments, asking how their outcomes should be implemented. He imagines the Justices in the caboose of a train, looking backward. Their job is to reflect upon the deeper meaning of the direction chosen by the people. As the train changes direction, new vistas are revealed, and familiar ones are seen in a fresh light. In this wonderfully graphic metaphor, Ackerman notes that the "distinctive thing about the judges . . . is that they remain in the caboose, looking backward—not in the locomotive arguing over the direction the train should be taking at the next crossroads." *Id.* at 546. From this backward-looking perspective, Ackerman develops a fascinating and, I think, true picture of constitutional jurisprudence as an effort to interpret and reconcile the conflicting results of constitutional moments.

For an analysis of the intellectual structure of constitutional transformations, see Lipkin, *The Anatomy of Constitutional Revolutions*, 68 NEB. L. REV. 701 (1989) (applying Thomas Kuhn's theory of scientific revolutions to "constitutional revolutions").

*Storrs Lectures* endorse an active role for the Supreme Court in overturning the legislative victories won by transformative social movements.<sup>337</sup> By sitting on the legislative steam valve, the Supreme Court alerts the people that a major change is in the offing, giving the opposition an opportunity to mobilize and forcing the transformative movement to raise the level of political struggle to a "fever pitch."<sup>338</sup> *Lochner* and, perhaps, *Dred Scott* thus emerge as examples of the proper exercise of judicial review.<sup>339</sup>

This view bears an unmistakable resemblance to the tongue-in-cheek revolutionary slogan: "The worse the better!" In order to maintain a sharp distinction between the two tracks of lawmaking, Ackerman would have courts nullify the legislative outcomes of popular republican politics, thus forcing a constitutional showdown. As we have seen, this approach writes off all but three popular upsurges, about one every seventy years, and seemingly approves of intensifying the level of struggle to the point that armed combat may be necessary to decide the issue—as occurred in two of Ackerman's three periods.

Although judicial hostility may at times intensify republican moments by pushing social movements to greater efforts, the more straightforward and likely result is the spreading of cynicism and political apathy. Thus, for example, the judicial nullification of the early civil rights statutes and the populist-inspired economic regulation thwarted and demoralized instead of inspiring the radical republican and populist movements. And, as William Forbath has suggested, a combination of labor injunctions and judicial nullification of labor's legislative victories during the late 19th and early 20th centuries may have been decisive in transforming the American labor movement from a broad social movement into a narrow, commercially-oriented interest group.<sup>340</sup>

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<sup>337</sup> See Ackerman, *supra* note 73, at 1050-55. As Professor Michelman put it, the Court is thus "cast as the agent of our constitutional past." Michelman, *supra* note 58, at 1521.

<sup>338</sup> See Ackerman, *supra* note 73, at 1050, 1053.

<sup>339</sup> See *id.* at 1053-57. Although Ackerman refers to *Dred Scott* as a "judicial failure," *id.* at 1051, it seems to have performed the same vital "higher lawmaking" functions that he attributes to the economic due process cases, namely focusing popular attention and escalating the level of struggle.

<sup>340</sup> See Forbath, *supra* note 95, at 1116, 1148-49. Similarly, Karl Klare has argued that the Supreme Court's narrow construction of labor's rights under the Wagner Act contributed to the decline of rank and file participation and the rise of bureaucracy in the industrial unions. See Klare, *Judicial Deradicalization of the Wagner Act and the Origins of Modern Legal Consciousness, 1937-1941*, 62 MINN. L. REV. 265, 336 (1978).

This part suggests that statutes resulting from a process of heightened political participation and public awareness should be broadly construed, both by courts and administrative agencies. In making this proposal, my aim is not to develop a comprehensive theory of statutory interpretation, but to suggest that one important consideration should be reaping the maximum gain from our occasional and costly republican moments.

### A. Statutory Construction

Courts employ two basic methods in dealing with ambiguities, gaps, and conflicts in statutory language: broad and narrow construction. A judge applying broad construction abstracts the question of legislative intent to the level of purpose. She identifies the primary purpose of the statute and construes ambiguities, fills gaps, and resolves conflicts so as to effectuate that purpose. Instead of asking whether Congress intended, for example, to prohibit some activity which is not explicitly mentioned in the statute, she asks whether the prohibition of that activity is necessary to carry out Congress's purpose in enacting the statute. This approach is embodied in the principle that remedial statutes are to be broadly construed.

A judge applying narrow construction, on the other hand, interprets the legislation as she would a contract. To borrow Professor Easterbrook's description, a judge

first identifies the contracting parties and then seeks to discover what they resolved and what they left unresolved. For example, [s]he may conclude that a statute regulating the price of fluid milk is a pact between milk producers and milk handlers designed to cut back output and raise price, to the benefit of both at the expense of consumers. [She] then implements the bargain as a faithful agent but without enthusiasm; asked to extend the scope of a back-room deal, [s]he refuses unless the proof of the deal's scope is compelling.<sup>341</sup>

This method corresponds to the traditional maxim that statutes in derogation of the common law are to be narrowly construed.

The Supreme Court regularly employs both methods.<sup>342</sup> The

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<sup>341</sup> Easterbrook, *Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4, 15 (1984).

<sup>342</sup> Although the canon calling for narrow construction of statutes in derogation of the common law is rarely cited, see W. ESKRIDGE & P. FRICKEY, *LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY* 657 (1988), the method is often

Court is rarely clear, however, on why it has selected one rather than the other.<sup>343</sup> Professor Easterbrook has suggested that broad construction should be applied to "general-interest" statutes, narrow to "private-interest" statutes.<sup>344</sup> A law prohibiting murder is a clear example of the former, a tobacco subsidy of the latter.

In borderline cases—which constitute the great majority—Easterbrook suggests that the courts should search for evidence that the statute resulted from a deal among private interests. Specifically, they should look at three factors: (1) the statutory language (the more detailed it is, the more likely there was interest-group give-and-take); (2) indicators of rent-seeking (e.g., statutory barriers on new entry to the regulated industry, subsidies extracted from one group and granted to another, and prohibitions against buying and selling statutory entitlements); and (3) the legislative process (e.g., who lobbied for the legislation, and what deals were struck). A statute enacted without a serious contest among interest groups is, in Easterbrook's view, more likely to be in the general interest.<sup>345</sup>

Were all statutes to be found on the spectrum from general to private interests, Easterbrook's proposal would amount to nothing more than economic due process writ small. The second factor would ensure that redistributive statutes were construed narrowly. The third factor, with its emphasis on consensus, would relegate the

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applied. Perhaps the most striking examples are decisions construing the right to engage in "concerted activities for . . . mutual aid or protection" under the National Labor Relations Act. 29 U.S.C. § 157 (1988). The Court has often construed this broad language narrowly in order to avoid infringing employers' common law rights. See, e.g., *NLRB v. Local 1229, Int'l Bhd. of Elec. Workers*, 346 U.S. 464, 475 (1953) (construing § 7 to exclude certain conduct because the "legal principle that insubordination, disobedience or disloyalty is adequate cause for discharge is plain enough"); *NLRB v. Mackay Radio & Tel. Co.*, 304 U.S. 333, 345 (1938) (holding that the NLRA did not deprive the employer of "the right to protect and continue his business" by permanently replacing employees who were exercising their § 7 right to strike). For discussion of these and other cases narrowly construing workers' statutory rights in order to preserve employer common law rights, see J. ATLESON, *VALUES AND ASSUMPTIONS IN AMERICAN LABOR LAW* (1983); Klare, *supra* note 340.

The method of broad construction is used regularly, often with citation to the canon calling for broad construction of remedial statutes. See, e.g., *Gomez v. Toledo*, 446 U.S. 635, 639 (1980) (describing 42 U.S.C. § 1983 as "remedial legislation . . . to be construed generously to further its primary purpose" (citation omitted)).

<sup>343</sup> See 3 J. SUTHERLAND, *STATUTES AND STATUTORY CONSTRUCTION* § 60.02 (N. Singer 4th ed. 1986) ("Every statute that makes any change in the existing body of law, excluding only those enactments which merely restate or codify prior law, can be said to 'remedy' some flaw in the prior law or some social evil.").

<sup>344</sup> See Easterbrook, *supra* note 341, at 16.

<sup>345</sup> See *id.* at 16-17.

legislative victories of controversial social movements to similar treatment.

Easterbrook recognizes, however, that some statutes "are designed to implement principles of morality" and thus "cannot easily be analyzed on a continuum between public interest and private interest."<sup>346</sup> This point raises new questions: how are morality-implementing statutes to be recognized, and what method of construction is appropriate? Easterbrook does not address these questions other than suggesting that morality-implementing statutes are to be distinguished from statutes designed "to influence economic conduct."<sup>347</sup> Thus depicted, morality-implementing statutes are beyond the scope of Easterbrook's project, which is to assess the Supreme Court's performance vis-à-vis the economic system.

The dichotomy between statutes designed to implement morality and statutes designed to influence economic conduct is transparently false. Many statutes are intended, at least in part, to impose moral strictures on economic activity. By its terms, the Federal Trade Commission Act prohibits "unfair," not inefficient, methods of competition.<sup>348</sup> There is no inherent contradiction between moral and economic conduct.

Ackerman's notion of higher-track lawmaking, supplemented by the theory of republican moments, suggests a more appropriate axis of comparison. Statutes that result from higher track lawmaking—call them "republican" statutes<sup>349</sup>—should receive a broad construction; products of interest group bargaining should, as Easterbrook suggests, be narrowly construed. The many statutes that fall in the nether zone between these two categories should be con-

<sup>346</sup> *Id.* at 17. Similarly, Judge Posner identifies a category of statutes which are "based on public sentiment rather than on either an objective weighing of demonstrable pros and cons or on cartel-like pressures for redistributing wealth." Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263, 271 (1982). Posner suggests that these statutes "cannot readily be defended on economic grounds given our existing and deficient knowledge of their effects." *Id.* Although Posner suggests that they are too important to be ignored, the existence of these statutes has no discernable impact on his proposals for proper statutory construction.

<sup>347</sup> Easterbrook, *supra* note 341, at 17.

<sup>348</sup> See Federal Trade Act, ch. 311, 38 Stat. 717, § 5 (1914) (codified at 15 U.S.C. § 45(a)(1) (1988)).

<sup>349</sup> As used here, the term "republican statutes" serves a similar function to that of "reform statutes" as used in a 1977 article by Professor Blumrosen. See Blumrosen, *Toward Effective Administration of New Regulatory Statutes*, 29 ADMIN. L. REV. 87 (1977).

strued according to whatever background rule is in effect—broad construction according to some,<sup>350</sup> narrow according to others.<sup>351</sup>

Republican statutes may be identified by examining their history for the factors associated with republican moments: (1) widespread and serious public discussion; (2) debate framed in terms of principle and public good; (3) an intention to bring about major changes in the legal order; (4) direct citizen action, such as social protest; and (5) extensive activity by voluntary associations and social movements. These factors precisely negate the picture of the legislative process that shapes Easterbrook's (and other public choice theorists') view of interest group bargaining: back-room deals among self-interested power brokers dividing the spoils of government.

Consider, for example, the contrast between the process leading to enactment of the Civil Rights Act of 1964 and that giving rise to the Smoot-Hawley Tariff of 1930.<sup>352</sup> The Civil Rights Act was preceded by a period of public discussion triggered by militant protests.<sup>353</sup> Religious groups led the push for legislation.<sup>354</sup> The legislative history is full of fundamental rights rhetoric.<sup>355</sup>

In contrast, the Smoot-Hawley Tariff was enacted almost entirely through the efforts of interest groups pursuing protection for their own product markets.<sup>356</sup> Public participation and arguments of principle were conspicuous by their absence.

For a more difficult test of the distinction, consider the National Labor Relations Act of 1935 ("NLRA") and the 1959 Landrum-Griffin amendments to the NLRA. Both involved restrictions on

<sup>350</sup> See H. HART & A. SACKS, *supra* note 7, at 1409-10.

<sup>351</sup> See Macey, *supra* note 12, at 264-66.

<sup>352</sup> Eskridge and Frickey use this pair of polar opposites to illustrate the difference between an instance of successful Madisonian deliberation and a special interest statute. See W. ESKRIDGE & P. FRICKEY, *supra* note 342, at 40.

<sup>353</sup> See T. BROOKS, WALLS COME TUMBLING DOWN: A HISTORY OF THE CIVIL RIGHTS MOVEMENT 1940-1970 214-35 (1974); A. MORRIS, *supra* note 149, at 274.

<sup>354</sup> See J. SUNDQUIST, POLITICS AND POLICY: THE EISENHOWER, KENNEDY, AND JOHNSON YEARS 268-69 (1968); Findlay, *Religion and Politics in the Sixties: The Churches and the Civil Rights Act of 1964*, 77 J. AM. HIST. 66 (1990).

<sup>355</sup> See W. ESKRIDGE & P. FRICKEY, *supra* note 342, at 3, 13, 15. Throughout the lengthy congressional maneuvers and debates, civil rights protesters kept up the pressure. See T. BROOKS, *supra* note 353, at 228-35.

<sup>356</sup> See W. ESKRIDGE & P. FRICKEY, *supra* note 342, at 40-46 (condensing and commenting upon E. SCHATTSCHNEIDER, POLITICS, PRESSURES AND THE TARIFF: A STUDY OF FREE PRIVATE ENTERPRISE IN PRESSURE POLITICS, AS SHOWN IN THE 1929-1930 REVISION OF THE TARIFF (1935)).

economic activity and both were contested by a similar cast of interest group representatives. The NLRA was, however, the product of a broad-based social movement seeking fundamental reform in the system of labor relations. During the period leading up to its enactment, civil libertarians and religious leaders joined with workers in an escalating campaign for the right to organize.<sup>357</sup> They broke through politics-as-normal with demonstrations, strikes, and acts of civil disobedience. "In 1934," as Irving Bernstein succinctly put it, "labor erupted" in countless strikes, including successful general strikes in San Francisco and Minneapolis.<sup>358</sup> Although many special interest statutes have come into being with a sugarcoating of reformist rhetoric, the legislative history of the NLRA leaves no doubt that its proponents contemplated a dramatic shift in the system of industrial relations toward collective bargaining and away from unilateral employer control.<sup>359</sup> By all accounts, the Act wrought profound changes.<sup>360</sup>

The 1959 amendments to the NLRA present an interesting contrast. In addition to the amendments, the Landrum-Griffin Act enacted a new law designed to combat internal union corruption and autocracy. This law, the Labor Management Reporting and Disclosure Act, began as a response to widespread public concern over intra-union corruption, which the McClellan Committee had spotlighted vividly in a highly-publicized series of hearings.<sup>361</sup>

<sup>357</sup> See J. AUERBACH, *LABOR AND LIBERTY* 26-32 (1966).

<sup>358</sup> See I. BERNSTEIN, *supra* note 148, at 217, 236; see also *supra* notes 100-01 and accompanying text.

<sup>359</sup> As originally introduced, the bill proclaimed:

The tendency of modern economic life toward integration and centralized control has long since destroyed the balance of bargaining power between the individual employer and the individual employee, and has rendered the individual, unorganized worker helpless to exercise actual liberty of contract, to secure a just reward for his services, and to preserve a decent standard of living, with consequent detriment to the general welfare and the free flow of commerce.

S. 2926, 73d Cong., 2d Sess. § 2, 78 CONG. REC. 3444 (1934). The ultimate statement of purpose mentioned the "inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and employers," 49 Stat. 449 (1935), but emphasized the harm to commerce as part of a strategy to have the Act upheld under the commerce clause. See I. BERNSTEIN, *supra* note 148, at 344-45.

<sup>360</sup> See, e.g., W. LEUCHTENBURG, *FRANKLIN D. ROOSEVELT AND THE NEW DEAL 1932-1940*, at 151 (1963) (describing the Act as "radical"); Klare, *Traditional Labor Law Scholarship and the Crisis of Collective Bargaining Law: A Reply to Professor Finkin*, 44 MD. L. REV. 731, 756 (1985) (collecting additional quotations to the same effect).

<sup>361</sup> See A. MCADAMS, *POWER AND POLITICS IN LABOR LEGISLATION* 11 (1964).



The NLRA amendments were added later during a series of maneuvers by interest group lobbyists.<sup>362</sup> While the NLRA amendments sparked the main controversy in Congress, public participation was limited to letter writing, and then only in reaction to campaigning by interest group staffers and speeches by political figures, most prominently President Eisenhower.<sup>363</sup> Neither management nor labor was able to attract active support from other constituencies. Throughout the process, the amendments were thought of as incremental adjustments, not as fundamental reforms. In short, none of the indicators of higher-track lawmaking were present.

Of course, the distinction will not always be easy for judges to make. As Jonathan Macey has pointed out, judges "interpret statutes; they are not investigative reporters."<sup>364</sup> It is much easier, however, to identify republican statutes than to single out interest group statutes, the problem that concerned Macey. While interest group politics thrive in smoke-filled rooms, citizen self-government is out in the open for all to see. A judge need not be an investigative reporter to recognize that, for example, the Civil Rights Act and the NLRA were products of exceptional citizen involvement.

The identification of republican statutes is not as "value-laden and political"<sup>365</sup> as is Easterbrook's distinction between public interest and special interest statutes. Although Easterbrook's distinction requires a substantive conception of the public interest (which, in his view, should be defined according to the highly controversial theory of neoclassical economics), republican statutes can be singled out by a relatively procedural test. The criteria listed above do not, for example, distinguish between a "pro-choice" and a "pro-life" law, or between neoclassical and critical economic philosophy, or even between social Darwinism and socialism. They

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<sup>362</sup> The principal amendments, those restricting secondary boycotts and organizational picketing, were added at the behest of management lobbyists after unions had succeeded in attaching their own NLRA "sweeteners" to the anti-corruption provisions of the Senate version. *See id.* at 49-54.

<sup>363</sup> *See id.* at 193-96, 210-12.

<sup>364</sup> Macey, *supra* note 12, at 239.

<sup>365</sup> *See* Farber & Frickey, *supra* note 11, at 908-10 (arguing against mandating judges to distinguish between public interest and special interest statutes because of the danger that the purported public interest would "simply correspond with the judge's favored political program").

embody only the admittedly value-laden, but imminently defensible, preference for active citizen democracy over special interest politics.

Whatever the difficulties of identifying republican statutes, they pale in comparison to the drawbacks of not making the attempt. Macey, for example, would jettison broad construction altogether because many purportedly remedial statutes are merely a "guise for the transfer of wealth to some favored group."<sup>366</sup> Judge Posner proposes the same result out of concern that a broad construction would "upset the compromise that the statute was intended to embody."<sup>367</sup> While Macey and Posner would relieve judges of the necessity for determining which statutes are remedial, they would also condemn the products of higher-track lawmaking to the same cramped construction accorded interest group statutes, thus insulating special interest politics against republican legislation. The obstacles to movements for higher lawmaking are formidable enough without forcing them to run a final gauntlet of narrow construction.

In response to an earlier draft of this proposal, a number of readers expressed the fear that the legislative victories of reactionary social movements would be entitled to a broad construction. The right-to-life movement has, for example, been known to engage in higher-track lawmaking as defined here. The obvious answer is that any serious supporter of democracy must be prepared to accept the possibility that the people may disagree with her personal views. As long as the popular republican process is not sabotaged by repression,<sup>368</sup> its legislative products warrant broad construction regardless of their conservative or liberal content.

### B. *Administrative Implementation*

We have seen how difficult it is for social movements to overcome politics-as-normal and win reform legislation. The difficulties do not end with the signing of a bill into law. After the legislative victory, administrators must enforce the new law in an environment that is conducive to interest-group politics. Professor Blumrosen's description of the problem warrants extended quotation:

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<sup>366</sup> Macey, *supra* note 12, at 265-66.

<sup>367</sup> Posner, *Statutory Interpretation—in the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800, 809 (1983).

<sup>368</sup> See *supra* text accompanying notes 112-14.

We can safely begin our analysis with the proposition that achieving reform is difficult under any conditions. Implementing reforms may be costly to the regulated community; may require changes in individual and institutional behavior which has been traditional and appears legitimate to the individuals involved; may imply guilt or immorality where none is felt by the individuals involved and may appear wrong or unnecessary to respondent personnel. And reform almost always introduces uncertainty which tends to immobilize respondents rather than lead them toward compliance. Faced with resistance based on these factors, the administrator's task is virtually impossible unless it can be demonstrated that substantial compliance with the reform legislation will actually be required. The basis for such an assertion finally—and initially—must be an interpretation of the law itself. . . . Yet 'administrative discretion' permits the agency to avoid this fundamental point by a variety of devices including endless study, leaving the matter 'to the courts,' or a narrow interpretation of the statute.<sup>369</sup>

Blumrosen suggests that courts should stiffen agency resolve by requiring broad construction of reform statutes.<sup>370</sup> Although the Supreme Court does require broad construction on occasion,<sup>371</sup> it has failed to articulate any principle explaining when it will and when it will not.<sup>372</sup>

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<sup>369</sup> Blumrosen, *supra* note 349, at 94.

<sup>370</sup> *See id.* at 97.

<sup>371</sup> A famous example is *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971). There, the Secretary of Transportation was directed by statute not to supply federal funds for highways routed through public parks unless there was no "feasible and prudent" alternative route. *Id.* at 405. The Court rejected the Secretary's contention that this provision entitled him to consider the economic and social costs of alternative routes, reasoning that Congress intended "that protection of parkland was to be given paramount importance." *Id.* at 412-13.

<sup>372</sup> Instead, deferential and critical standards co-exist, with no stated criteria for choosing between them. The basic rule calls for the courts to defer to an agency's statutory construction unless Congress has "directly addressed the precise questions at issue" and clearly expressed its intent. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984). This standard carves out a wide zone for agency discretion; it precludes courts from overturning agency constructions on the basis of purposive reasoning, broad inferences from statutory structure, or legislative history not directed to the particular point at issue. *Chevron*, however, also set forth a nondeferential counterprinciple. Recognizing that courts have the final say on matters of law, the *Chevron* Court announced that if "a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect." *Id.* at 843 n.9. Of course, purposive reasoning, inferences from statutory structure, and general legislative history are all among the "traditional tools of statutory construction." If courts were to apply the full kit of traditional tools, *Chevron's*

Professor Blumrosen's proposal would resolve a large number of the most important cases. Unfortunately, he does not tell us how to distinguish a reform statute from other kinds of legislation. This gap can be filled with the criteria proposed here for identifying republican statutes.<sup>373</sup> When the process leading to the enactment of a statute transcends politics-as-normal, the agency enforcing it should be protected against the onslaught of interest group politics afterward.

Thus elaborated, Blumrosen's rule has clear advantages over other proposals for reducing the impact of special interest politics on agency decisions. Instead of giving the courts a broad mandate to trump agency statutory construction<sup>374</sup>—a power that has often been used to shackle aggressive agency construction of republican statutes<sup>375</sup>—it enlists the courts in an effort to maximize the results of higher lawmaking.

### CONCLUSION

Strong democracy comes in pulses. During republican moments, large numbers of normally quiescent citizens enter the public arena to struggle for their visions of the common good. Passion and moral commitment set the tone for public discourse. Groups that are underrepresented in special interest bargaining use mass

deferential principle would be swallowed up by its critical counterprinciple, as happened three years later in *INS v. Cardoza-Fonseca*, 480 U.S. 421, 449 (1987) (using *Chevron's* critical counterprinciple and overturning an agency's statutory construction based on purposive reasoning and overarching legislative history as well as specific statutory language). *Chevron* and *Cardoza-Fonseca* are only the latest manifestations of a split that goes back four decades, to the time before the enactment of the Administrative Procedure Act. See S. BREYER & R. STEWART, *ADMINISTRATIVE LAW AND REGULATORY POLICY* 272-73 (2d ed. 1985); *id.* at 288 n.1 (Supp. 1988). For a persuasive explanation of the Court's non-deferential approach in *Cardoza-Fonseca*, see Eskridge, *supra* note 20, at 1032 (suggesting that the Court was unwilling to defer to the agency interpretation in part because it disadvantaged a discrete and insular minority).

<sup>373</sup> See *supra* text accompanying notes 351-52.

<sup>374</sup> See, e.g., Macey, *supra* note 12, at 263-64; Sunstein, *Constitutionalism*, *supra* note 20, at 469.

<sup>375</sup> See, e.g., *NLRB v. Fansteel Metallurgical Corp.*, 306 U.S. 240 (1939) (overturning the NLRB's determination that a sit-down strike in protest of employer unfair labor practices is protected concerted activity); *NLRB v. Sands Mfg. Co.*, 306 U.S. 332 (1939) (overturning the NLRB's holding that an employer violated the NLRA by discharging employees for threatening a strike during the term of a collective bargaining agreement that lacked a no-strike clause). See generally Klare, *supra* note 340, at 265 (discussing how the Court's narrow conception of legitimate union activity barred labor from participating in social change).

protest and other forms of direct power to place their concerns on the public agenda. Aroused citizens disrupt cozy relationships among politicians, administrators, and interest group lobbyists.

Republican moments are the times when the basic direction of the country (or state or municipality) is at issue, and our core ideals of liberty and equality become matters of urgent concern to broad sections of the populace. Most of the great rights we celebrate today were products of the unruly and passionate politics of republican moments.

Talk of strong democracy and direct popular power sounds romantic in these times of hard-nosed economism. Paradoxically, however, direct popular power provides an effective, if partial and temporary, antidote to three of the most serious political evils identified by the economic theory of collective action. First, social movements use direct power to overcome the "free-rider" problem and other barriers to political participation, in the process replacing public choice theory's "logic" of collective action with an alternative logic of collective empowerment and moral choice. Second, direct popular power can dislodge or bypass the logjam created by interest group bargaining, thus redirecting the public agenda away from private deals and toward basic issues of public policy. Finally, direct popular power enables groups that are underrepresented in interest group bargaining to offset—if only for a moment—the disproportionate influence enjoyed by compact, wealthy interest groups during politics-as-normal.

The Constitution, of course, erects a system of representative—not direct—democracy. Its most effective proponents sought to temper special interest politics with deliberations among an elite of virtuous representatives, not with pulses of direct popular power. The Bill of Rights, however, added a potentially subversive supplement to the representative scheme.

Read in context, the first amendment carves out the constitutional space for direct popular power. In the political theory and practice of the founding generation, the right of the people peaceably to assemble encompassed not only the right to meet, but also to exercise extra-institutional forms of power, ranging from nonviolent rallies and boycotts to the displacement of representative government by popular assemblies. Direct power was seen as a necessary corrective to the natural tendency of government to degenerate into corruption and tyranny. Here, as elsewhere, the framers deliberately built a conflict into the constitutional scheme,

this one between representative government and direct popular power.<sup>376</sup>

The theory of republican moments has two major implications for legal doctrine. First, it provides arguments for expanding the protection of direct popular power under the first amendment. Understanding the long-run functions of direct power may help to forge the kind of civic courage that can sustain a commitment to free speech and assembly in the midst of popular tumult.<sup>377</sup>

Second, the theory suggests that courts and administrative agencies should give a broad construction to the statutory and constitutional products of republican moments. For brief periods of time, at a considerable cost to business-as-normal, direct popular power offsets the worst flaws of interest group bargaining. These times should be seen as precious—albeit unsettling—moments of strong democracy. The resulting statutes, which I have called “republican statutes,” embody unusually accurate expressions of the popular will. When the level of participation subsides, courts and administrative agencies should serve as agents of the republican moment, preserving the thrust of republican statutes against the inevitable lethargy and corruption of interest group bargaining. Failure to do so can only reflect, as Frederick Douglass lamented when the Supreme Court invalidated the Civil Rights Act of 1875, a failure of historical memory.<sup>378</sup>

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<sup>376</sup> Far from erecting a unitary structure of government, our Constitution “constitutes a system of conflicts.” Leubsdorf, *Deconstructing the Constitution*, 40 STAN. L. REV. 181, 192 (1987).

<sup>377</sup> See Blasi, *The First Amendment and the Ideal of Civic Courage: The Brandeis Opinion in Whitney v. California*, 20 WM. & MARY L. REV. 653, 679-80, 682-83 (1988) (summarizing Brandeis’s ideal of civic courage and commenting on its role in first amendment jurisprudence).

<sup>378</sup> See Blight, “*For Something beyond the Battlefield*”: Frederick Douglass and the Struggle for the Memory of the Civil War, 75 J. AM. HIST. 1156, 1159 (1989).

POLITICS, BUREAUCRACIES, AND FINANCIAL MARKETS:  
BANK ENTRY INTO COMMERCIAL PAPER  
UNDERWRITING IN THE UNITED  
STATES AND JAPAN

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Americans writing about Japan seem to fall into two camps: those who think the Japanese act according to very different rules than Americans, so that the apparent similarities between the two peoples actually mask deep cultural differences;<sup>1</sup> and those who think that the Japanese and the Americans are really rather similar, so that the obvious cultural differences cover more deep-rooted continuities.<sup>2</sup>

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<sup>1</sup> The classic cultural account of Japanese society is R. BENEDICT, *THE CHRYSANTHEMUM AND THE SWORD: PATTERNS OF JAPANESE CULTURE* (1946). See also T. DOI, *THE ANATOMY OF DEPENDENCE* (1973); C. NAKANE, *JAPANESE SOCIETY* (1970). Recent accounts by Western observers include J. MORLEY, *PICTURES FROM THE WATER TRADE* (1985), and P. TASKER, *THE JAPANESE: A MAJOR EXPLORATION OF MODERN JAPAN* (1987). A superb general treatment of modern Japanese history and society is E. REISCHAUER, *THE JAPANESE* (1977).

<sup>2</sup> The leading legal scholar who argues for deep-seated similarities between Japan and the United States is J. Mark Ramseyer. See, e.g., Ramseyer & Nakazato, *The Rational Litigant: Settlement Amounts and Verdict Rates in Japan*, 18 J. LEGAL STUD. 263, 290 (1989) (arguing that although culture is important, "the current emphasis on culture in comparative studies of Japanese law deflects attention from . . . mundane incentive structures"); see also Ramseyer, *The Costs of the Consensual Myth: Antitrust Enforcement and Institutional Barriers to Litigation in Japan*, 94 YALE L.J. 604, 604-05 (1985) (explaining the behavior of litigants as it pertains to cultural characteristics); Ramseyer, *Legal Rules in Repeated Deals: Banking in the Shadow of Cheats in Japan*, (forthcoming J. LEGAL STUD. (Jan. 1991)) (discussing the system of "main banks" in Japan, and Japanese banks' treatment of troubled borrowers); Ramseyer, *Takeovers in Japan: Opportunism, Ideology and Corporate Control*, 35 UCLA L. REV. 1, 4-6 (1987)

There may be no authoritative way to resolve this debate, since what is important in terms of cultural differences lies largely in the eye of the beholder. Yet it is also possible that detailed investigation of a specific subject area might yield at least some insights into the question.

The present study is such a detailed investigation of a particularly intriguing—and economically significant—parallel development in Japan and the United States. In 1987, regulators in both Japan and the United States allowed commercial banks to enter the business of underwriting commercial paper (short-term, unsecured corporate promissory notes).

That this important development occurred in both countries at roughly the same time suggests support for the arguments of the continuity theorists. They believe that the Japanese and American systems are quite similar in their actual functioning, despite apparent cultural differences.

At the same time, however, the similarity in the actions taken by the two governments is matched by an equally striking dissimilarity in the methods by which those actions were brought about. In the United States, bank entry into the commercial paper market was initiated by a private institution, Bankers Trust New York Corporation. Federal regulators did not design or implement the marketplace changes and were largely cast in the role of reacting to changes that were already occurring. Some of the major government decisions allowing the market to go forward, moreover, were made by courts of law rather than the regulatory administrative agencies.

In Japan, by way of contrast, the development of a commercial paper market with bank involvement was carefully controlled at every step by a government agency, the Ministry of Finance (MOF). No private entity took the initiative to move the process forward by entering the commercial paper business without prior MOF approval. Moreover, in Japan, litigation was not only absent, but was never seriously considered as a step towards resolution of the

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(discussing the phenomenon of takeovers in Japan and considering these implications as they pertain to the American experience); Ramseyer, *Water Law in Imperial Japan: Public Goods, Private Claims, and Legal Convergence*, 18 J. LEGAL STUD. 51, 53 (1989) (discussing the "similarities between [the Japanese] legal regime and the prior-appropriation regime in the American West"). Although the theory set forth in the present study differs in some respects from Ramseyer's general views on the subject, the authors are greatly in his debt for defining the debate and for many insightful observations.



controversy. The views of those interests affected were made known to the government through an elaborate series of *ex parte* contacts at all levels of seniority. This is something that would have been unthinkable, and probably illegal, at many stages of the proceedings in the United States.<sup>3</sup> These differences in method lend some support to proponents of the difference hypothesis, who would suggest that, despite the apparent similarity of result, the whole process was radically different due to cultural influences.

Our view, based on an examination of this one limited, albeit important, development in the commercial life of Japan and the United States, is that neither the similarity nor the difference hypothesis fully explains the evidence under review. In both countries the question of bank involvement in commercial paper distribution was a fundamental bone of contention between two powerful industries, banks and securities firms, because commercial paper represents a deep threat to the core banking business of providing short term credit to business enterprises. In each case, the political battle over commercial paper was fought by powerful and well-organized special interest groups, and resolved in part by bureaucratic agencies anxious to preserve their regulatory "turf."<sup>4</sup> Although to a casual observer the Japanese events may have appeared more cordial and less nakedly self-interested than the American experience, they actually involved an interest-group battle of ferocious intensity raging within the relatively private confines of the MOF. The nature of the events in Japan was revealed to us

<sup>3</sup> The Administrative Procedure Act, 5 U.S.C. §§ 551-559, 701-706 (1988), prohibits communications between any "member of the body comprising the agency, administrative law judge, or other employee who is or may reasonably be involved" and anyone involved in the decision-making process or an interested party outside the agency, if such communications are relevant to the merits of the proceeding. *Id.* § 557(d).

<sup>4</sup> A recent and perhaps notorious example of this sort of behavior in the United States took place when officials of the Securities and Exchange Commission sought to divest the Commodities and Futures Trading Commission of its jurisdiction over the regulation of stock-index futures. *See, e.g., Egan, Coping with Stock-Market Tremors*, U.S. NEWS & WORLD REP., Aug. 13, 1990, at 66 (noting that "[e]fforts by Treasury Secretary Nicholas Brady to give the Securities and Exchange Commission authority to regulate stock-index futures as well as stocks have bogged down in a jurisdictional wrangle between the SEC and the Commodity Futures Trading Commission, the current overlord"); Hinden, *Brady Loses in Fight for Futures Bill; Senate Panels Scuttle Provision on Control*, Wash. Post, July 28, 1990, at D10, col. 6 (noting that Treasury Secretary Nicholas Brady had "lobbied hard for passage" of legislation that would have reassigned jurisdiction over the regulation of stock-index futures from the CFTC to the SEC but had faced "the implacable opposition of the CFTC, the Chicago futures market and members of Congress with close ties to the agricultural industry").

through our research which included interviews with many of the key participants in both government and the private sector and which focused on the actual mechanics of the Japanese decision.<sup>5</sup> There is no evidence that the Japanese motives were any more noble or less self-interested than those of the American participants.

At the same time, there are undeniable and important differences between the Japanese and American approaches to the conflict. In part, we find that these differences stem from variations in institutional structure. Because the Japanese MOF has overarching responsibility for both securities firms and banks, the conflict between these industries was channeled inside the walls of that agency rather than spilling out into the public arena. The latter was the case in the United States where banks, but not securities firms, are represented and influential within the relevant agency (the Federal Reserve Board<sup>6</sup>).

In part, the differences also appear to reflect the influence of factors that could be labeled "cultural." Japanese society—at least the Japanese commercial society that we studied—is marked by the extensive use of "preclearance":<sup>7</sup> conflicts are addressed and resolved in a variety of settings by informal and private means before any party is forced to take a public stand on an issue. It is this feature of preclearance that generates the popular cliché of

<sup>5</sup> In researching this Article, we conducted detailed discussions with over 30 individuals in Japan, including high-ranking officials at the Ministry of Finance, the Ministry of International Trade and Industry, and the Bank of Japan, important professors from law faculties, including the University of Tokyo, officials from leading securities houses and banks, and representatives of the Japan Securities Research Institute and the Japan Bankers Association. We found all our informants to be both knowledgeable and extraordinarily forthcoming about the inner workings of the decision process in Japan. We also interviewed leading securities traders and bank officials in the United States.

The present study is outside the tradition of American law review articles in that it is based largely on the results of detailed interviews with actual participants in the process. Our goal has been to look behind the formal documentation of decisions to determine more precisely the actual forces which shaped the outcome. In addition, as we discuss below, *see infra* text accompanying note 10, our focus is not simply on the development of legal doctrine, but rather on the complex and subtle interplay among four great social systems: politics, markets, technology, and law. We believe that our interviewing technique is a useful supplement to the written record as a means for bringing into clearer focus the influence of each of these four systems and the complex interplay among them.

<sup>6</sup> We use the term "Federal Reserve Board" interchangeably with other popular locations, including Federal Reserve and the Fed.

<sup>7</sup> For a fuller discussion on the "preclearance-postclearance" distinction, see *infra* text accompanying notes 205-27.

Japanese society as based on "consensus." The appearance of consensus does not indicate any lack of conflict within Japanese society; rather, it reflects the fact that conflicts are typically addressed and resolved in advance of any overt public confrontation. In contrast, decisions in the United States are often reached by "postclearance" mechanisms, in which parties are free—indeed, encouraged—to take public stands that generate confrontation for the relevant decision-maker's formal, on-the-record resolution. The history of the commercial paper struggle in the two countries amply illustrates the difference between preclearance and postclearance methods of dispute resolution.

It is not at all evident that one method is better than another in any a priori sense. A naive view might see the Japanese system as intrinsically better because fewer social resources are devoted to conflict resolution. This view is notoriously present in Derek Bok's famous jeremiad on the American legal profession,<sup>8</sup> which he portrays as draining the best talent away from more fruitful occupations such as business, medicine, or education. Bok suggests that the United States would benefit by becoming more like the Japanese, with their minuscule lawyer-to-population ratio and mighty productive capacities. Yet, aside from the factual shortcomings in Bok's critique,<sup>9</sup> it is grossly shortsighted because it fails to recognize the presence in Japan of a pervasive, and extremely resource-intensive, system of dispute resolution through preclearance.

An approach more sophisticated than Bok's might attempt to determine whether the Japanese preference for preclearance and the American preference for postclearance represent intrinsic differences between the two cultures, or simply different choices by the relevant decision-makers. By studying one set of analogous decisions in the two nations, we can gain insight into the relationship between behavior and culture in the United States and Japan.

In examining the developments in Japan and the United States, we consider the interplay of four factors: politics, markets,

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<sup>8</sup> See Bok, *A Flawed System of Law Practice and Training* 33 J. LEGAL EDUC. 570 (1983).

<sup>9</sup> For example, Bok fails to observe that although the ratio of *bengoshi* (people who have passed the bar) to population is much lower than the American lawyer-to-population ratio, the ratio of law school graduates to population in Japan is much higher than in the United States. Many of these law graduates go on to careers that in the United States would require a license to practice law. See Tsubota, *Myth and Truth on Non-Litigiousness in Japan*, 30 U. CHI. L. SCH. REC. 8, 9 (1984).

technology, and law. Rather than viewing the law relating to commercial paper in isolation from the other three, we see that each factor profoundly shapes the law. As we demonstrate below, the evolution of the law in the commercial paper area had an important political dimension; indeed, in both the United States and Japan, the legal developments were largely, although not wholly, driven by the influence of powerful political interest groups. Technology also influenced the events recounted here: as world markets have become linked through modern computer and communications facilities, markets in both the United States and Japan have increasingly been able to "securitize" assets.<sup>10</sup> The role of the financial intermediary has accordingly become less crucial to developed economic systems over the past decade than it was previously. And market developments such as the growth of money market mutual funds, the increasing globalization of financial markets, and the dramatic weakness shown in parts of the American banking and securities industries over the past few years have all contributed to the unfolding of the events recounted in this study.

At the same time, we do not view the legal environment simply as a passive product of these other systemic developments. Although changes in the law may be influenced or even caused by developments in politics, markets, and technology, legal changes also influence the other systems by altering political alignments, restructuring markets, and stimulating the development of new technologies. Thus, the relationships of all four systems are deeply reciprocal. Economic history is the result of the dynamic interplay among them.

This politics-markets-technology-law perspective on economic history is inherently complex in structure. No one variable can be identified to "explain" any particular development, although lines of proximate causality often can be traced with some degree of confidence. All developments depend on the influence of a variety of different variables, operating within an overall system that is moving constantly towards equilibrium but, at the same time, is disturbed repeatedly by new and often unexpected developments. Thus, the discussion that follows does not identify any single factor that uniquely explains the developments in Japan or in the United States. It does identify, at least tentatively, the concatenation of

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<sup>10</sup> See generally Comment, *Collateralized Mortgage Obligations: Probing the Limits of National Bank Powers Under the Glass-Steagall Act*, 36 CATH. U.L. REV. 1025 (1987) (discussing legal limitations on national banks to securitize mortgage assets).

causes that together influenced these developments, and it offers some thoughts as to why these particular constellations of forces may have arisen, and why the mix of factors differed between Japan and the United States.

This Article is structured as follows. Part I provides a brief introduction to commercial paper, and to the structure of the American and Japanese financial services industries. Part II examines the American experience with bank entry into the commercial paper market. Part III treats the parallel Japanese experience. Finally, Part IV ties the two histories together and draws conclusions about their similarities and differences.

## I. BACKGROUND

Commercial paper is one of the various devices which corporations use to raise funds. It is a short-term, unsecured obligation of the corporation, issued for a fixed amount and bearing a fixed rate of interest. Commercial paper occupies a middle ground between stocks and bonds, on the one hand, and commercial loans on the other; it is sold in a market like stocks and bonds, rather than being individually negotiated like commercial loans, but the sales generally occur by private placement, rather than through public offerings.

For the issuers, commercial paper is an attractive financing vehicle because it provides ready access to capital markets without requiring extensive negotiations or creating long-term obligations. For investors, it is attractive because it pays higher interest than most bonds or treasury bills, and yet is relatively safe; while the paper is not backed by any specified assets, its short-term character means that any major issuer is unlikely to decline to the point of insolvency during the brief period before the paper matures. In addition, commercial paper may be backed by a letter of credit from a bank or other financial institution.

From this description, one might assume that the amount of commercial paper that a corporation issues, relative to other financing instruments, is a matter of interest primarily to students of economics or business administration. In certain European countries, such as West Germany, where there are virtually no restrictions on a bank's range of activities, this is in fact the case. In the United States and Japan, however, commercial paper has become a major political, regulatory, and legal issue because of the separation of financial institutions into banks and securities firms. In both nations, deposit-taking institutions—that is, banks—have

been allowed to make commercial loans but have been prohibited from underwriting securities. This excludes banks from being the primary manager, or underwriter, of corporate securities issues, since the underwriter's role is typically to buy the entire issue and take the risk that some of it cannot be sold at the original price. Instead, underwriting is performed by investment banks, which are actually securities firms that buy and sell for their own accounts and engage in various other transactions. To maintain the separation of commercial banks and investment banks, the investment banks are prohibited from accepting deposits.<sup>11</sup>

In recent years, there has been a collision between the legal regime separating commercial banks from securities firms and the intermediate character of commercial paper.<sup>12</sup> Because commercial paper can readily substitute for commercial loans, banks want to participate in marketing it. Only the larger, more stable, corporate borrowers can issue commercial paper, but those are naturally the customers that banks are most anxious to retain. Because commercial paper can substitute for corporate securities, however, the securities firms (investment banks) would like to keep the banks out of the market. To them, bank participation in commercial paper transactions represents an incursion into a field that previously has been their exclusive and highly profitable preserve.

<sup>11</sup> The prohibition on deposit-taking by investment banks is contained in § 21 of the Glass-Steagall Act, 12 U.S.C. § 378 (1988). For a comprehensive discussion of the Glass-Steagall Act and its implications for commercial banks and securities firms, see H. PITT, J. WILLIAMS, D. MILES & A. AIN, *THE EVOLVING FINANCIAL SERVICES INDUSTRY* (1985).

<sup>12</sup> See, e.g., Macey, *Special Interest Groups Legislation and the Judicial Function: The Dilemma of Glass-Steagall*, 33 EMORY L.J. 1, 4 (1984) (noting that "the commercial paper market is in direct competition with commercial bank loan departments as a source of credit to top industrial borrowers"); Comment, *Securities Activities Under the Glass-Steagall Act*, 35 EMORY L.J. 463, 463 (1986) (discussing recent conflicts arising between commercial banks and securities firms).

Most recently, the Federal Reserve Board authorized a commercial bank, J.P. Morgan, to underwrite equity securities. See Duke & Smith, *Fed Allows J.P. Morgan to Underwrite Stocks*, Wall St. J., Sept. 21, 1990, at C1, col. 3. The Fed's favorable response to the Morgan application represented the first time a bank has been empowered to engage in such underwriting since 1933. See *id.* The Fed's move generated controversy in the investment community. See, e.g., Power & Salwen, *Winners, Losers Take Stock of Glass-Steagall Battle: Securities Industry Has Little Leverage*, Wall St. J., Sept. 24, 1990, at C1, col. 3 (noting effort by securities industry to maintain a competitive advantage in light of the decision of the Federal Reserve); Sease, *Winners, Losers Take Stock of Glass-Steagall Battle: Banks Bask in Equity-Underwriting Victory, but New Role May Prove Symbolic for Now*, Wall St. J., Sept. 24, 1990, at C1, col. 5 (noting that while the Fed decision is of strategic importance to banks, it may not represent an immediate threat to the securities industry).

The conflict between banks and securities firms in the United States and Japan emerged from a similar legal background, but developed differently because of dissimilarities in the economic and regulatory regimes in the two countries. In the United States, the existence of commercial paper preceded the separation of banking and securities firms. There has been a commercial paper market in America since the end of the eighteenth century.<sup>13</sup> It evolved from the use of bearer promissory notes as short-term financing vehicles; the merchant would write the note, and a dealer would arrange its sale at a discount to a third party or, more rarely, purchase the note with an intent to resell it at a higher price. The incentive for relying on this mechanism was the endemic credit shortage in many parts of the country, particularly in the South and the West. Since American banks were limited to operating in one state at the most, and often to one city or one branch, credit did not flow readily from one part of the country to another. The sale of commercial paper was a relatively effective means of establishing a nation-wide credit market.

The early dealers in commercial paper tended to be private money brokers or merchant houses who would bring the buyer and the issuer together for a suitable commission. In the late nineteenth century, some of the dealers began to purchase the paper for their own accounts. A few banks dealt in commercial paper as well, either as brokers or, more frequently, by purchasing the paper and then reselling it to other banks with which they had correspondent relationships. For the most part, however, banks were in the commercial paper market as buyers rather than dealers.

These practices and, indeed, the entire structure of the American financial services industry, were transformed by the legislation following the financial crisis of the Great Depression. In 1933, the Glass-Steagall Act<sup>14</sup> effected the separation of banking and securities dealing, although it is unclear whether the motivation for passage of this Act was concern about commercial bank insolvency or the lobbying efforts of the investment banks.<sup>15</sup>

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<sup>13</sup> For the history of the United States commercial paper market, see generally, N. BAXTER, *THE COMMERCIAL PAPER MARKET* (2d ed. 1966); A. GREEF, *THE COMMERCIAL PAPER HOUSE IN THE UNITED STATES* (1938); Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525 (1977).

<sup>14</sup> 12 U.S.C. § 24, paras. 7, 78, 377-78 (1988).

<sup>15</sup> See Macey, *supra* note 12, at 15-21 (arguing that the Glass-Steagall Act was enacted as the result of interest-group pressures). But see Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking*

Section 16 of the Act limits a commercial bank to buying and selling securities "without recourse, solely upon the order, and for the account of, customers, and in no case for its own account . . . ."<sup>16</sup>

Section 21 forbids firms which buy and sell for their own account, or which underwrite securities, from engaging "to any extent whatever in the business of receiving deposits . . . ."<sup>17</sup> Technically, the Glass-Steagall Act applies only to banks that are members of the Federal Reserve System, and the wording of its provisions is far from being air-tight. Nonetheless, the Act was long regarded as barring commercial banks from dealing in commercial paper, whether by acting as brokers (placing the paper with buyers) or as underwriters (purchasing for their own account with an intent to resell). This view was so well accepted that banks did not attempt to deal in commercial paper for nearly fifty years.

The banks' hands-off attitude towards commercial paper undoubtedly reflected the stability and profitability of commercial banking during the post-Depression period. With a rapidly-expanding economy generating increasing demands for commercial loans, banks had little economic incentive to enter the commercial paper market. That market, moreover, had declined precipitously even before the Depression; between 1920 and 1933 the amount of commercial paper outstanding fell from one billion to one hundred and thirty-nine million dollars.<sup>18</sup> Many dealers left the market or merged, with the result that market concentration increased rapidly. By 1938, nine major dealers controlled ninety percent of the market. These conditions continued through the 1960s, and kept the commercial paper market from seeming like either a threat or an opportunity to commercial banks.<sup>19</sup>

In the late 1960s, however, large corporations began to rely increasingly on commercial paper to fund their short term financing needs. The spreads and placement costs on commercial paper fell low enough that a corporation could often save money by going directly into the commercial paper market rather than by obtaining funds from a bank or another financial intermediary.<sup>20</sup> In addi-

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*Regulation*, 85 MICH. L. REV. 672, 716-17 (1987) (arguing that the Glass-Steagall Act was intended "as much as anything . . . to redirect the resources and energies of the banking industry back to the historic role as provider of commercial credit").

<sup>16</sup> 12 U.S.C. § 24, para. 7 (1988).

<sup>17</sup> *Id.* § 378(a)(1).

<sup>18</sup> See Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. CHI. L. REV. 362, 362 n.2 (1972) (citing N. BAXTER, *supra* note 13, at 17).

<sup>19</sup> See *id.* at 365-66.

<sup>20</sup> From 1964 to June 1971, the savings differential on commercial paper as



tion, many corporations relying on bank loans for financing were effectively forced to issue commercial paper in 1966 when bank credit temporarily dried up as a result of high nominal interest rates.<sup>21</sup> Once having entered the commercial paper market, many firms were reluctant to return to higher-cost bank financing even when bank funds became readily available again.<sup>22</sup> Commercial paper outstanding grew fivefold, from \$10.1 billion in 1966 to \$52.6 billion in 1976.<sup>23</sup> Banks, to their surprise and dismay, began to see commercial paper as a threatening competitor for their core loan business.<sup>24</sup>

The problem was not simply a loss of loan revenues, although this was bad enough. In addition, commercial banks were deprived of key information about the activities of their loan customers. In the days when corporations returned to their banks frequently to roll over commercial loans, banks were able to maintain regular contact with their customers and thus to obtain reliable, current information about them. That source of information began to dry up as blue chip corporations increasingly turned to the commercial paper market for their short-term financing needs. Faced with these circumstances, banks began to reevaluate the long-accepted notion that the Glass-Steagall Act prohibited them from dealing in commercial paper.

In Japan, the separation of banking and securities firms preceded the development of commercial paper as a mechanism for corporate finance. The separation was effected by article 65 of the Securities and Exchange Law of 1948 (SEL)<sup>25</sup> which was imposed on Japan during the American occupation. SEL prohibits banks, *inter alia*, from underwriting securities, engaging in the public offering of outstanding securities, and handling the public offering of new or outstanding securities.<sup>26</sup> This law represented a departure from the pre-war organization of the Japanese financial services industry. Following the Meiji Restoration of 1868,<sup>27</sup> Japan had

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compared with the bank prime rate was approximately .93%. *See id.* at 365 n.10.

<sup>21</sup> *See* Hurley, *supra* note 13, at 531-32.

<sup>22</sup> *See id.* at 532.

<sup>23</sup> *See id.* at 525.

<sup>24</sup> *See id.* at 525 (noting that "[f]or the firms that issue it, commercial paper is an important substitute for bank credit"); Interview with Thomas A. Parisi, Senior Vice President, Bankers Trust Company (Apr. 11, 1989) [hereinafter Parisi interview].

<sup>25</sup> Law No. 25 of 1948.

<sup>26</sup> *See id.* at art. 65, para. 1.

<sup>27</sup> The Meiji Restoration, along with infusion of Chinese culture and the establishment of the Shogunate, was one of the great turning points in Japanese history. The

developed a universal banking system organized along European lines. Securities underwriting was dominated by government banks, such as the Industrial Bank of Japan, and banks that were members of the great industrial groups, or *zaibatsu*, such as Mitsui Bank. Securities firms existed, but acted only as brokers and distributors of issues to the general public. The imposition of article 65 was a product of the interesting American belief that a democratic regime not only required free elections, free speech, and due process, but also antitrust laws and the Glass-Steagall Act.<sup>28</sup>

From the Japanese perspective, article 65 "fulfills no domestic policy purpose and exists only by virtue of historical accident."<sup>29</sup> As one might expect, engrafting this provision upon an already well-developed financial services industry led to different results from those that its original produced in the United States. Most notably, the old *zaibatsu* have managed to knit together business alliances, called *keiretsu*, and retain many of their pre-war relationships on an informal basis. These relationships are cemented by a practice of cross-shareholding, where each member company owns up to 5% of the equity in the other companies. Banks participate in this practice, just as they participated in the erstwhile *zaibatsu* system. Cross-shareholding is permissible under article 65 which states that banks may purchase securities for their "own investment purpose[s]."<sup>30</sup> While the United States Comptroller of the Currency construed the analogous Glass-Steagall language to permit only the purchase of marketable debt instruments, not stock, article 65 has been construed as permitting stock purchases. Moreover, Japanese banks, unlike American banks, are not forbidden from affiliating with securities firms. Thus, a securities firm can become a member of a *keiretsu* that includes a bank. All of the major Japanese banks

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Meiji Restoration marked the downfall of the Shogun and the beginning of a modern state in Japan, under the guise of restoring the Emperor to his throne. For a general discussion, see, e.g., J.W. HALL, JAPAN FROM PREHISTORY TO MODERN TIMES 265-72 (1970) (discussing political and cultural effects of the Meiji Restoration); P. TASKER, *supra* note 1, at 20-23 (describing Western influence on Japan during the Meiji Restoration); and M. YOSHINO, JAPAN'S MULTINATIONAL ENTERPRISES 3-6 (1976) (explaining the causes and describing the effects of the Meiji Restoration).

<sup>28</sup> For a discussion of American sponsored reforms in the Japanese financial sector, see F. ROSENBLUTH, FINANCIAL POLITICS IN CONTEMPORARY JAPAN 39-41 (1989). For a general discussion of legal reforms effected during the American occupation of Japan, see E. REISCHAUER, *supra* note 1, at 105-09.

<sup>29</sup> Dale, *Japan's "Glass-Steagall Act,"* 2 J. INT'L BANKING L. 138-41 (1987).

<sup>30</sup> Law No. 25 of 1948.

have become informally affiliated with one or more securities firms.<sup>31</sup>

As a matter of practice, it appears that Japanese banks can in fact participate in underwriting Japanese corporate debt despite the SEL's specific prohibitions. They do so by acting as "commissioned underwriting companies," which means they serve as advisor, agent, and trustee for the issuing corporation. Banks also assume the default risk in case the issuing company becomes insolvent. This practice is done not as a legal obligation, since article 65, like the Glass-Steagall Act, forbids doing so, but as a moral one, legally unenforceable but well-recognized and well-accepted.<sup>32</sup> American banks do not assume such moral obligations. Even if they were to declare that they would assume such obligations, securities buyers would not believe them. The inability of United States banks to declare *ex ante* that they will guarantee corporate debt means that they cannot compete with investment banks that are permitted to engage in firm commitment underwriting. Since Japanese banks can credibly commit themselves to assume the risks of the debt securities they place, they are able to play a significant role in underwriting corporate debt.

Despite these differences and the more lenient interpretation Japanese authorities have given their imported article 65, this provision is not without effect in Japan. The separation of the banking and securities businesses has led to the evolution of independent securities firms with their own corporate identity, markets to defend, and network of political influence. The four largest firms have evolved into powerful financial institutions. One of these, Nomura Securities, can reasonably be regarded as the most formidable (and profitable) company in the Japanese financial services industry.<sup>33</sup> Thus, when the conflict over commercial paper arose, Japanese banks, despite the porous nature of article 65 restrictions, found themselves facing a worthy set of adversaries.

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<sup>31</sup> See Dale, *supra* note 29, at 139 (noting the commonality of the practice); *A Survey of Japanese Finance*, ECONOMIST, Dec. 10, 1988, at 13-14.

<sup>32</sup> See Nagao, *The Bond Market*, reprinted in E. SAKAKIBARA & Y. NAGAO, *STUDY ON THE TOKYO CAPITAL MARKETS* 63-64 (1985) (remarking that "in the case of an actual default . . . it is the commissioned bank which has protected the investor by purchasing such outstanding bonds at par value").

<sup>33</sup> See, e.g., A. ALLETZHAUSER, *THE HOUSE OF NOMURA* xi (1990) (stating that "Nomura has more assets under custody than . . . the world's largest bank; makes more money than any financial firm in the world; controls 20% of the Japanese bond market; and dominates the Eurobond underwriting tables").

This conflict did not emerge until the late 1970s for the simple reason that there was no commercial paper in Japan. The only short-term financial markets in existence prior to that time were the call market, the bill discount market established by the Bank of Japan in 1971 in which financial institutions trade discounted promissory notes issued by corporations, and the *gensaki* market, a market for bonds with repurchase agreements that gained prominence and official recognition in the 1970s. The call market is limited to financial intermediaries, while the bill discount market is further restricted to commercial banks and money brokers. Moreover, until very recently, the market for short-term Japanese government debt has been insignificant.<sup>34</sup>

Only the *gensaki* market was open to sizeable investment by non-financial corporations. As a market for bonds with repurchase agreements, however, it does not provide most corporations with a method for borrowing short-term funds. Only a corporation that holds a large portfolio of long-term bonds can raise short-term funds by *gensaki* transactions, selling bonds with repurchase agreements. Because of the lack of a commercial paper or similar market, Japanese industry essentially lacked any alternative to short-term financing from banks.

Bank borrowing was, and to a lesser extent continues to be, the dominant method of raising both short and long-term capital for industry. Banking itself is divided into several distinct markets. Commercial banks are restricted to the market for deposits of three years or less duration. Smaller commercial banks, the regional and mutual banks, generally have a net excess of funds deposited through extensive branch networks. They supply some of these excess funds to the twelve large commercial banks called the City Banks. The City Banks dominate short-term finance to large corporations by serving as the "main banks" of these corporations. Several City Banks form the nuclei of the *keiretsu*. They tended to be "overloaned" throughout the high-growth era, borrowing from the smaller banks through the interbank call and bill discount markets and from the Bank of Japan's discount window.<sup>35</sup>

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<sup>34</sup> See *Opening the Door to Japan's Short-Term Money Markets*, ECONOMIST, Apr. 1, 1989, at 65 (noting that Japan's treasury bill market is only one twenty-fourth the size of the United States' treasury bill market).

<sup>35</sup> See Wallich & Wallich, *Banking and Finance*, in *ASIA'S NEW GIANT: HOW THE JAPANESE ECONOMY WORKS* 249, 284-90 (H. Patrick & H. Rosovsky eds. 1976); see also Y. SUZUKI, *MONEY AND BANKING IN CONTEMPORARY JAPAN* 3-13 (1980) (explaining the concept of "overloan" and noting that in the early 1970s Japan was the only major

The seven trust banks and three long-term credit banks are restricted to the longer-term market segments. Both groups are permitted to raise medium- and long-term funds in order to provide longer-term capital for industrial development.

While deregulation has begun to blur distinctions between trust banks, long-term credit banks, and commercial banks, the City Banks still dominate short-term finance for large Japanese corporations. Smaller commercial banks, trust banks, and long-term credit banks therefore did not have much direct interest in the commercial paper debate. In the controversy described below, the City Banks did most of the lobbying and negotiating.

## II. THE AMERICAN EXPERIENCE

### A. *The Bankers Trust Initiative in Placing Commercial Paper*

In 1978, Bankers Trust Company, a state-chartered member bank of the Federal Reserve System, challenged the prevailing view that the Glass-Steagall Act barred banks from any substantial role in the distribution of commercial paper. Bankers Trust did so by acting as agent for several large corporate customers that wanted to place commercial paper with investors.<sup>36</sup> The company's decision to enter the market was apparently defensive: Bankers Trust was not seeking to poach on the turf of securities firms, but rather to protect its core loan business and customer relations against competition from securities firms.<sup>37</sup>

It is not clear why Bankers Trust adopted a "go it alone" strategy. To be sure, as a major city bank serving the credit needs of large corporations, Bankers Trust had much to lose from commercial paper competition. But so did other big banks, such as Citibank, Chase Manhattan, and Manufacturers Hanover. There were significant free rider effects in this situation. By acting unilaterally, Bankers Trust benefitted not only itself, but also its rival banks which stood to profit from a ruling allowing bank involvement in the commercial paper market. Furthermore, it

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country in which the central bank was a net lender).

<sup>36</sup> Banks previously had purchased commercial paper for their own accounts and had acted for customers in purchasing paper, but had not represented issuers in distributing it. See Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks, 46 Fed. Reg. 29,333, 29,334 n.4 (1981).

<sup>37</sup> See Horowitz, *Bankers Trust Moves Ahead in Commercial Paper, Suit by Suit*, AM. BANKER, Sept. 23, 1987, at 16, 24.

might well have been cheaper and safer for Bankers Trust to seek prior Federal Reserve Board approval for its commercial paper activities. Bankers Trust would probably have received the support of other big commercial banks in any proceeding before the Federal Reserve, or before the courts on petition for review of the Board's decision.

Bankers Trust's decision to follow the arguably riskier course of unilateral action was apparently designed to gain a number of advantages. First, the decision-makers at Bankers Trust no doubt understood that a dealer must work in volume to survive in the commercial paper business.<sup>38</sup> Accordingly, Bankers Trust may have hoped to get a jump on other commercial banks as a dealer in commercial paper. If so, its strategy succeeded: even today it is the leading bank in the market, although its market share falls short of the leading securities firms.<sup>39</sup> Second, Bankers Trust believed that gaining a toehold in the market, while not necessarily profitable in itself, would allow it to establish lines of communication with corporate customers that would place it in an advantageous position for selling other, more profitable, bank services.<sup>40</sup> Third, Bankers Trust had decided in 1978 to focus on wholesale as opposed to retail banking, and to develop an in-house investment banking capability.<sup>41</sup> Entry into the commercial paper market was an important step in this direction. Finally, Bankers Trust may have

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<sup>38</sup> As of December 1988, Bankers Trust handled approximately \$11 billion in commercial paper outstanding (i.e., unmatured paper placed by a company at any given time), representing less than 5% of the market. Although it was the sixth largest player in the market, as measured by the amount outstanding, its market share was far below those of the four leading securities firms: Merrill Lynch (\$70 billion outstanding), Goldman Sachs (\$60 billion), Shearson Lehman Hutton (\$55 billion) and First Boston Corp. (\$30 billion). See Neustadt, *Big Banks Make Gains Placing Corporate Paper*, AM. BANKER, Dec. 6, 1988, at 1, 14.

It is not at all clear that even with programs totaling \$11 billion Bankers Trust was able to make a profit. Trading professionals we interviewed believe that the break even point for commercial paper placement is approximately \$25-30 billion, as evidenced by the fact that Salomon Brothers dropped out of the commercial paper market with approximately \$28 billion of commercial paper outstanding. See Interview with Richard Fuscone & T. James Smithwick of Merrill Lynch Money Markets Inc. (Apr. 11, 1989) [hereinafter Fuscone & Smithwick interview].

<sup>39</sup> See Neustadt, *supra* note 38, at 14.

<sup>40</sup> See Parisi interview, *supra* note 24.

<sup>41</sup> See *id.* Traders we interviewed at other firms indicated that Bankers Trust was known in the market as having a "good trading desk" and a "trading mentality or mindset," stemming partly from the influence of its Chairman, who was widely known as an innovative force within the banking industry.

intended to establish a reputation as a dynamic innovator in the financial services industry.<sup>42</sup>

In all likelihood, Bankers Trust consulted informally with Federal Reserve Board officials before actually entering the commercial paper market.<sup>43</sup> No law prevented this type of informal consultation, and the bank could only gain from it, given the virtual certainty of a legal challenge from the securities industry which would draw the Board into the decision sooner or later. We do not know whether or not Bankers Trust received any informal assurances from Board officials. We are confident, however, that Bankers Trust would not have proceeded unilaterally if it suspected that the Board would disapprove, given the Board's enormous discretionary powers over banking institutions and its reputation for punishing banks which provoke it.<sup>44</sup>

The securities industry quickly sought to quash the Bankers Trust commercial paper program. The Securities Industry Association (SIA), a national trade association of securities firms, approached the Board on an informal basis to complain of the activity.<sup>45</sup> When the Board declined to act, the SIA—acting on

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<sup>42</sup> A Bankers Trust officer we interviewed denied this motivation, however. *See id.*

<sup>43</sup> *See id.* We learned that the legal department of Bankers Trust engaged in extensive communications with the regulators, and probably advised them of the planned entry into commercial paper. It should be noted that these informal consultations represent a form of "preclearance" which, as we argue throughout this paper, is more characteristic of Japanese than American decision-making. However, Bankers Trust knew that the Board was its ally on this issue; thus the prior consultation was not a form of conflict resolution of the sort that occurs so widely in Japan. Moreover, our argument is not that preclearance is absent in the United States—or postclearance in Japan—but rather that the United States and Japan differ dramatically in the degree to which the two methods are used.

<sup>44</sup> A revealing glimpse into the powers of the Board is provided in a story well-known in the banking community. The episode involved the Board's treatment of New Jersey's Horizon Bank in 1985 after that institution had won approval from the Comptroller of the Currency to relocate a branch across state lines. Interstate branching of any sort threatens the Board's regulatory jurisdiction, which operates principally at the holding company level. *See, e.g., Miller, Interstate Branching and the Constitution*, 41 BUS. LAW. 337, 338 (1986) (examining "the constitutionality of state laws that prohibit entry by branches of out-of-state banks"). The Board reportedly responded to Horizon's action by threatening to refuse check-clearing services to the bank, a move which would have devastated the bank's operations. Not surprisingly, Horizon dropped the idea of an interstate branch. *See Rehm, Bradfield Bids Reluctant Adieu to the Fed*, AM. BANKER, Feb. 21, 1989, at 1. Although the Board official involved in that matter has departed from the scene, the object lesson about the Board's powers remains cogent.

<sup>45</sup> *See Securities Indus. Ass'n v. Board of Governors of the Fed. Res. Sys.*, 468 U.S.

behalf of the securities industry—formally petitioned for a ruling that the Bankers Trust activities violated sections 16 and 21 of the Glass-Steagall Act.<sup>46</sup> The Board denied the petition in 1980.<sup>47</sup> Applying a functional analysis, the Board determined that commercial paper was not a “security” subject to the Act since its economic role is more akin to a standard commercial bank loan than to a corporate security. The Board did recognize, however, that the Bankers Trust activities posed potential hazards, and accordingly issued a “policy statement” restricting the terms under which member banks could enter the market.<sup>48</sup>

The consequence of the Board’s decisions was to create a system of administrative control virtually unfettered by statutory standards. By first declaring that commercial paper is not a security and then imposing a relatively elaborate set of discretionary administrative constraints on bank involvement in commercial paper sales, the Board maximized its own administrative control of the situation and retained the flexibility to ease those constraints as the market evolved. In contrast, if the Board had declared commercial paper to be a “security” it would have had no choice but to invalidate

137, 140 (1984) [hereinafter *Bankers Trust I*].

<sup>46</sup> Section 16 of the Act provides, in relevant part, that

[t]he business of dealing in securities and stock by [a commercial bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [bank] shall not underwrite any issue of securities or stock.

12 U.S.C. § 24, para. 7 (1988). Section 21(a)(1) makes it unlawful for

any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor.

*Id.* § 378(a)(1).

<sup>47</sup> See *Bankers Trust I*, 468 U.S. at 141.

<sup>48</sup> The most important restrictions were the following: member banks were limited to selling “prime quality” paper to “financially sophisticated” investors; they were not permitted to advertise to the general public; they could not sell paper with denominations below \$100,000; they were required to use due diligence in investigating the financial affairs of the issuer; and they were prohibited from selling commercial paper to fiduciary accounts over which they exercised investment discretion. See Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks, 46 Fed. Reg. 29,333, 29,334-35 (1981).



actions by member banks which constituted underwriting of commercial paper.

The SIA petitioned for review of the Board's order declaring commercial paper to be outside the scope of the term "security" in the Glass-Steagall Act. The case eventually reached the Supreme Court, which in 1984 reversed the Board and held commercial paper to be a "security" for purposes of the Act.<sup>49</sup> The Board's interpretation was flawed, according to the Court, because excluding commercial paper from the definition of a security under the Glass-Steagall Act would threaten some of the "subtle hazards" which, in the Court's view, Congress had feared when it enacted the statute. For example, the Court suggested that a bank's "salesman's interest" in a commercial paper issue might lead it to enhance the marketability of the paper by extending backup credit to the issuer.<sup>50</sup> In addition, the bank might purchase unsold paper which it was distributing, in order to establish its reputation as a reliable dealer, even if the paper did not meet ordinary credit standards,<sup>51</sup> or market commercial paper issues to its depositors, with the attendant danger of loss of confidence in the bank if the issuer were to default.<sup>52</sup> Finally, a bank's interest might cause it to slant its investment advice to depositors, especially if the proceeds of the commercial paper issuance were to go towards retiring an existing loan with the bank.<sup>53</sup>

The Supreme Court's decision was unusual in that the Court refused to defer to the views of an expert administrative agency on a subject within the agency's administrative competence.<sup>54</sup> It is probable that the Justices in the majority saw two chief problems with the Board's actions that warranted a departure from the usual rule of deference.

First, the Board had admitted that bank sales of commercial paper posed hazards. This was the basis for its order limiting the

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<sup>49</sup> See *Bankers Trust I*, 468 U.S. 137 (1984).

<sup>50</sup> See *id.* at 155.

<sup>51</sup> See *id.*

<sup>52</sup> See *id.* at 155-56.

<sup>53</sup> See *id.* at 156.

<sup>54</sup> The Court's failure to defer to the Board's interpretation was the basis for Justice O'Connor's lengthy dissent, joined by Justices Brennan and Stevens. See *Bankers Trust I*, 468 U.S. 137, 160-82 (1984); cf. *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-45 (1984) (stating that deference should be given to an executive department's construction of a statutory scheme it administers, and applying this deference to the Environmental Protection Agency's definition of a term in the Clean Air Act).

terms on which such sales could proceed. Since the Board had conceded that there were hazards, and since those hazards seemed similar, or identical, to the hazards that motivated Congress to enact the Glass-Steagall Act, it appeared incongruous that the Board should reject the applicability of the Act and then seek to control the hazards by fiat pursuant to its generalized authority to protect the safety and soundness of member banks. This seemed like a thinly disguised end run around the statute. The Board's orders thus "effectively convert[ed] a portion of the Act's broad prohibition into a system of administrative regulation."<sup>55</sup>

The Court's second principal objection was that the banking industry itself had apparently accepted its exclusion from commercial paper dealings without protest for nearly fifty years. As the Court observed, "it is certainly not without some significance that Bankers Trust's commercial-paper placement activities appear to be the first of that kind since the passage of the [Glass-Steagall] Act."<sup>56</sup> The Court observed that banks had "universally recognized" that underwriting commercial paper fell on the investment banking side of the Glass-Steagall divide.<sup>57</sup>

Accordingly, the Supreme Court's role at this stage of the controversy appears to have been a conservative one: preserving the status quo under which banks did not deal in commercial paper, championing a perceived congressional intent, and resisting administrative tinkering with the statute for contemporary policy purposes.

The securities industry's apparent victory in the *Bankers Trust I* case did not end the dispute, however. At the end of its opinion, the Court dropped a suggestive footnote, observing that it was not deciding whether the activities undertaken by Bankers Trust constituted the "underwriting" of securities. This was important. Section 16 of the Glass-Steagall Act prohibited only commercial bank involvement in the "underwriting" of securities.<sup>58</sup> Securities brokerage, as opposed to underwriting, appeared to be expressly allowed by the Act, which recognized the power of commercial banks to purchase and sell securities "without recourse, solely upon the order, and for the account of, customers."<sup>59</sup> Section 21 of the

<sup>55</sup> *Bankers Trust I*, 468 U.S. at 153.

<sup>56</sup> *Id.* at 159-60.

<sup>57</sup> *See id.* at 160.

<sup>58</sup> *See id.* at 160 n.12.

<sup>59</sup> *See* 12 U.S.C. § 24, para. 7 (1988).

Act only prohibited firms engaged in "the business" of underwriting or distributing securities from acting as depository institutions.<sup>60</sup> Bankers Trust's commercial paper operations would not violate the Glass-Steagall Act if they did not constitute "underwriting" or "distributing" commercial paper. Thus the Supreme Court's 1984 decision merely represented a battle won by the securities industry, but did not resolve the war.

On remand, the Board decided that the Bankers Trust placement of commercial paper constituted the selling of securities without recourse and solely on the order and for the account of a customer, a practice permitted by sections 16 and 21 of the Act.<sup>61</sup> The decision went on to conclude that Bankers Trust was not "underwriting" securities because the term "underwriting" in the Act referred only to public offers, not to private placements of the sort undertaken by Bankers Trust. A federal district court reversed,<sup>62</sup> but the D.C. Circuit reinstated the Board's decision. It concluded that the Board's interpretation of the statute was entitled to deference and that the Bankers Trust program did not pose the sort of subtle hazards that the Supreme Court had considered in its earlier decision (*Bankers Trust I*).<sup>63</sup> Bankers Trust, accordingly, was free to proceed with its commercial paper placement program.

#### B. *The Bankers Trust Initiative in Underwriting Commercial Paper*

So far, Bankers Trust and, by implication, other member banks had gained only the power to act as agents in the placement of commercial paper. Underwriting would clearly be prohibited if performed by the banks. This meant that as a practical matter Bankers Trust could not purchase for its own account commercial paper which it was placing with other investors. According to Bankers Trust officials we interviewed, this limitation placed Bankers Trust at a competitive disadvantage relative to securities firms which were free from similar constraints;<sup>64</sup> Bankers Trust

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<sup>60</sup> See *id.* § 378(a)(1).

<sup>61</sup> The unpublished opinion is described in *Securities Indus. Ass'n v. Board of Governors of the Fed. Res. Sys.*, 807 F.2d 1052 (D.C. Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987) [hereinafter *Bankers Trust II*].

<sup>62</sup> *Securities Indus. Ass'n v. Board of Governors of the Fed. Res. Sys.*, 627 F. Supp. 695 (D.D.C. 1986), *rev'd*, 807 F.2d 1052 (D.C. Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987).

<sup>63</sup> See *Bankers Trust II*, 807 F.2d at 1067-70.

<sup>64</sup> See Parisi interview, *supra* note 24.

would be required to sell all of its customers' paper on the day of issue; if any were left over at the close of the day Bankers Trust could not purchase it. Bankers Trust proposed to the Board that it be allowed to make up any shortfall with a loan to the issuer at the commercial paper rate, but the Board refused.<sup>65</sup> Thus, Banker's Trust had gained a toehold, but not yet a position of competitive equality with securities firms: it could not underwrite commercial paper, nor could it make up shortfalls at the close of the day.

Bankers Trust and other large money center banks responded to this limitation in two ways. First, sometime in 1985, they developed a new financial product, the short-term securitized loan, as a partial substitute for commercial paper.<sup>66</sup> A bank would originate a loan with a maturity and interest rate similar to that of commercial paper, and then sell interests in the loan to other institutions. The effect is functionally similar to a commercial paper placement, but because the transaction is structured as a loan instead of a distribution of securities, the Glass-Steagall Act does not constrain the originating bank from taking an interest in the loan—i.e., from acting in a role functionally equivalent to underwriting.

Second, Bankers Trust applied to the Board of Governors for permission under the Bank Holding Company Act<sup>67</sup> to transfer its commercial paper activities to a second-tier subsidiary of the parent bank holding company. The Chicago-based subsidiary, BT Commercial Corporation, was engaged in making and servicing loans and in commercial leasing, activities previously declared by the Board to be permissible for nonbank subsidiaries of bank holding companies under the Bank Holding Company Act.<sup>68</sup> Bankers Trust's motive

<sup>65</sup> See *id.*

<sup>66</sup> See *id.*

<sup>67</sup> Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. § 1843(c)(8) (1988), permits bank holding companies to maintain nonbank subsidiaries, provided that the subsidiary's activities are "so closely related to banking or managing or controlling banks as to be a proper incident thereto . . ." Federal Reserve Board approval is required before a nonbank subsidiary may enter into any new line of business. At the time of the Bankers Trust application, the Federal Reserve Board had exempted a number of nonbanking activities either by order or in its Regulation Y, 12 C.F.R. § 225 (1990), but it had never addressed the question of whether commercial paper placement was permissible for a nonbank subsidiary.

<sup>68</sup> See Fidelity American Bankshares, Inc., Fed. Res. Bd. Order, [1972-1973 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 95,832, at 80,761-2 (Dec. 14, 1972) (holding that providing and servicing loans is "closely related to the business of banking" and, therefore, permissible for bank holding companies); Leasing Computer Equipment and Lease Financing, [1972-1973 Transfer Binder] Fed. Banking L. Rep.

in moving the commercial paper business over to its holding company did not arise out of a concern for short-term profit; in all probability, commercial paper placement per se could not be performed more efficiently out of a commercial finance subsidiary than out of the bank itself. Moreover, there was no obvious advantage (and perhaps some disadvantage) to running the commercial paper operation out of Chicago instead of New York. Although placing the operation in a nonbank bank holding company subsidiary offered the potential for geographic diversification free of restrictions under the Douglas Amendment to the Bank Holding Company Act,<sup>69</sup> there is no indication in the record that Bankers Trust intended to expand its commercial paper placement operations outside of Chicago. The most likely explanation is that the application was a strategic move designed as part of a long-range plan to position Bankers Trust as a leading commercial bank presence in the investment banking field, and, in particular, to allow eventual securities underwriting.

Bankers Trust had every reason to expect a favorable response to its application. The Board itself, and most importantly its powerful Chairman, Paul A. Volcker, had gone on record as supporting enhanced securities powers for bank holding companies, including the power to deal in commercial paper;<sup>70</sup> and the Bankers Trust application provided the Board with a convenient

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(CCH) ¶ 95,716 (June 29, 1972) (noting that transactions where a lease is the functional equivalent of an extension of credit to the lessee are permissible for bank holding companies).

<sup>69</sup> The Douglas Amendment to the Bank Holding Company Act of 1956, 12 U.S.C. § 1842(d) (1988), permits bank holding companies to own subsidiary banks outside their home state only if the state where the subsidiary is located has enacted legislation permitting the acquisition. See also *Northeast Bancorp, Inc. v. Board of Governors of the Fed. Res. Sys.*, 472 U.S. 159, 168-73 (1985) (interpreting the Douglas amendment).

<sup>70</sup> See, e.g., *Structure and Regulation of Financial Firms and Holding Companies (Part I): Hearings Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operations*, 99th Cong., 2d Sess. 165 (1986) (statement of Paul A. Volcker), reprinted in 72 Fed. Res. Bull. 541, 549 (1986) (noting that the Board has long supported an approach that would permit subsidiaries of bank holding companies to engage in underwriting and distributing commercial paper); *Financial Restructuring: The Road Ahead: Hearings on H.R. 5342, H.R. 4506 and H.R. 3537 Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce*, H.R. REP. NO. 144, 98th Cong., 2d Sess. (1984) (statement of Paul A. Volcker), reprinted in 70 Fed. Res. Bull. 312, 316 (1984) (noting the need to reexamine the limitations of banking organizations in light of the market changes, changes in technology, consumer needs, and the regulatory and economic environment).

means for accomplishing this policy objective.<sup>71</sup> Indeed, Bankers Trust probably had received informal prior assurances from Board staff that its application would not be unwelcome.<sup>72</sup> We were informed by a Bankers Trust official that the bank frequently consulted with the Board on a friendly and informal basis on the commercial paper question.<sup>73</sup>

The Bankers Trust application implicated section 20 of the Glass-Steagall Act,<sup>74</sup> which prohibits affiliations between member banks and organizations "engaged principally" in the securities business.<sup>75</sup> The Board held that actions permitted to a bank itself under sections 16 and 21 should not be denied to a bank affiliate under section 20.<sup>76</sup> Thus, because the Board had previously approved commercial paper placement activities by the bank itself, and that approval had been upheld by the D.C. Circuit,<sup>77</sup> the activity was permissible a fortiori for nonbank subsidiaries of bank holding companies.

The Board could have ended its analysis of the Glass-Steagall Act at this point, but it went on to provide an alternative basis for decision: even if the activities in question *did* constitute "underwriting" under section 20, they would not violate the Glass-Steagall Act because the securities subsidiary would not be "engaged principally" in such activity.<sup>78</sup> The Board held that the term "engaged princi-

<sup>71</sup> The Board could, in theory, have proceeded by informal rulemaking, amending Regulation Y to include acting as agent in the sale of commercial paper as part of the Regulation Y "laundry list" of activities generally permitted to nonbank subsidiaries of bank holding companies. However, the Board has traditionally added activities to Regulation Y only after determining by order in one or more concrete cases that the activity in question was permissible. Thus an initial rulemaking approach would have been out of the ordinary course and would have received attention in Congress and elsewhere. The Board may not have wanted to dramatize its action in this fashion.

<sup>72</sup> See *supra* note 34.

<sup>73</sup> See Interview with James Beckley (Apr. 11, 1989).

<sup>74</sup> 12 U.S.C. § 377 (1988).

<sup>75</sup> Section 20 provides, in pertinent part, that "no member bank shall be affiliated . . . with any . . . organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities . . ." See *id.* Congress extended this provision to insured nonmember banks in the Competitive Equality Banking Act of 1987, Pub L. No. 100-86, § 103, 101 Stat. 552, 566-67 (1987).

<sup>76</sup> See *Bankers Trust New York Corporation*, 73 Fed. Res. Bull. 138, 139-40 (1987) (citing *Board of Governors of the Fed. Res. Sys. v. Investment Co. Inst.*, 450 U.S. 46, 60 n.26 (1981)).

<sup>77</sup> See *Bankers Trust II*, 807 F.2d 1052 (D.C. Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987).

<sup>78</sup> See *Bankers Trust New York Corp.*, 73 Fed. Res. Bull. at 145-46.

pally" meant "any substantial line of business activity."<sup>79</sup> It concluded that the subsidiary would not be engaged principally in the securities business if its gross revenues from commercial paper activities constituted less than five percent of its total gross revenues and the company's total commercial paper outstanding represented less than five percent of the average amount of all dealer-placed commercial paper outstanding.<sup>80</sup>

The Board then examined the legal issues arising under the Bank Holding Company Act.<sup>81</sup> It held, first, that the proposed activities would be "closely related to banking" because commercial paper placement is similar to the traditional banking function of arranging loan participations with other banks and other institutional lenders.<sup>82</sup> It then held that the proposed activity represented a "proper incident" to banking because the public benefits of the activity (increased competition and greater customer convenience) outweighed the potential adverse effects (such as unfair competition, insider trading, and under concentration of resources).<sup>83</sup> The Board therefore approved the application, subject to several constraints proposed by Bankers Trust itself.<sup>84</sup>

The Board's decision to allow a bank holding company subsidiary to place commercial paper left open the question of whether it would be permissible for such a subsidiary to *underwrite* commercial paper—that is, to purchase such paper for its own account for resale to customers at a profit. That question came to the Board a few months later in the form of an application by The Chase Manhattan Corporation to underwrite and deal in third party commercial paper to a limited extent through a commercial finance subsidiary. The Board, relying on its earlier Bankers Trust decision, held that the

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<sup>79</sup> *Id.* at 142.

<sup>80</sup> *See id.* at 146.

<sup>81</sup> *See supra* notes 67-69 and accompanying text.

<sup>82</sup> Bankers Trust New York Corporation, 73 Fed. Res. Bull. at 147.

<sup>83</sup> *See id.* at 152.

<sup>84</sup> Among other limitations, the Board ruled that the subsidiary could place only prime quality short-term paper in minimum denominations of \$250,000; could place the paper only with sophisticated financial institutions; could not inventory unsold portions of the paper it placed, nor purchase such paper for its own account; could not earn revenues from commercial paper placement exceeding five percent of gross revenues in any given year; could not achieve a market share exceeding five percent of all dealer-placed paper at any one time; could not back the paper with which it dealt by letters of credit or guarantees; could not extend credit to issuers to cover unsold paper; could not provide investment advice to purchasers; and could not have officers, directors, or employees in common with any of the holding company's subsidiary banks. *See id.* at 152-53.

Chase subsidiary would not be "engaged principally" in the securities business, even though it would be underwriting rather than acting as agent, so long as it adhered to the five percent revenue limitation.<sup>85</sup> Relying on the Bankers Trust decision, it held further that the proposed commercial paper underwriting was a permissible activity for nonbank subsidiaries of bank holding companies under the Bank Holding Company Act, provided that the Chase subsidiary adhered to the limitations on operations imposed by the Board in the *Bankers Trust New York Corporation* case.<sup>86</sup>

### C. Further Breaches in the Glass-Steagall Barrier

The logic of these decisions was not limited to commercial paper. If a nonbank subsidiary could sell commercial paper as agent or underwriter, there was no apparent reason under the language of the Glass-Steagall Act why such an organization could not broker or sell all forms of securities, provided that the activity in question was not so substantial as to run afoul of the proscription in section 20 against "engag[ing] principally" in the securities business.<sup>87</sup> Although commercial paper marked the entering wedge into the securities business, it was clear that applications for other securities activities would not be far behind.

Indeed, at the time it decided the *Bankers Trust New York Corporation* and the *Chase Manhattan Corporation* cases, the Board had pending before it just such an application.<sup>88</sup> Three bank holding companies—Citicorp, J.P. Morgan & Co., and Bankers Trust New York Corporation—sought approval for nonbank subsidiaries to underwrite municipal revenue bonds, mortgage-related securities, consumer-receivable-related securities, and commercial paper. The subsidiaries designated to engage in these activities were then engaged in underwriting securities such as U.S. government and agency and state and municipal securities ("bank-eligible" securities) that member banks are permitted to underwrite under section 16 of the Glass-Steagall Act.<sup>89</sup>

<sup>85</sup> See *Chase Manhattan Corp.*, 73 Fed. Res. Bull. 367, 368 (1987).

<sup>86</sup> See *id.* at 371. The D.C. Circuit upheld the Board's decision in *Securities Indus. Ass'n v. Board of Governors of the Fed. Res. Sys.*, 847 F.2d 890 (D.C. Cir. 1988).

<sup>87</sup> 12 U.S.C. § 377 (1988).

<sup>88</sup> See *Chase Manhattan Corp.*, 73 Fed. Res. Bull. at 371.

<sup>89</sup> See *Citicorp/J.P. Morgan & Co./Bankers Trust*, 73 Fed. Res. Bull. 473, 473 (1987).



The *Citicorp/J.P. Morgan & Co./Bankers Trust* cases represented two further steps by commercial banks into the securities business. First, aside from commercial paper underwriting, which the Board had approved as closely related to banking in the *Chase Manhattan Corporation* case,<sup>90</sup> the securities involved in the later applications were relatively far-removed from the traditional banking business. It was unclear whether underwriting these securities would pass muster under the Bank Holding Company Act. Second, because the subsidiary companies in question were involved in underwriting government securities, there was a close question as to whether the existing business of these firms would be considered the "securities" business for purposes of section 20. If so, then the petitions would have to be denied because the subsidiary would be principally engaged (indeed, wholly engaged) in the securities business in violation of section 20. If, on the other hand, bank-eligible activities were excluded from the securities business to which section 20 applies, then the petitions might well be upheld because the bank-ineligible portion of the business might be considered insubstantial in comparison with the total volume of business conducted by the firm.

The applications thus raised important issues for the future of the financial services industry. The three bank holding companies sought, in essence, to be allowed to operate large-scale investment banking affiliates engaged in underwriting a wide variety of securities. Even the stringent five percent revenue test imposed by the Board in prior cases would not restrict seriously the operation of these proposed section 20 affiliates, at least not in the short run, because as primary dealers in government securities the firms brought in such an enormous amount of revenue that there were few practical impediments to conducting a full-scale underwriting business. In short, while approval of these applications did not quite have the potential of eviscerating the Glass-Steagall Act, it did create the possibility of allowing the kind of bank involvement in the securities business that the Act had long been thought to prohibit.

The Board approved the applications by a split decision, with Chairman Volcker and Governor Angell dissenting.<sup>91</sup> The majority rejected the contention that bank-eligible securities such as U.S.

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<sup>90</sup> See *Chase Manhattan Corp.*, 73 Fed. Res. Bull. at 368.

<sup>91</sup> See *Citicorp/J.P. Morgan & Co./Bankers Trust*, 73 Fed. Res. Bull. at 505-06.

government obligations fell within the term "securities" in section 20 of the Glass-Steagall Act, observing that such an interpretation would be inconsistent with the evident congressional intent to impose less burdensome restrictions on securities activities by affiliates than on activities by banks themselves.<sup>92</sup> The Board then applied its five percent gross revenue and market share limitations to the proposals in determining that the proposed bank-ineligible activities would not violate section 20's proscription against an affiliate being "engaged principally" in bank-ineligible securities activities.<sup>93</sup>

The Board then addressed the Bank Holding Company Act issues, and upheld as closely related to banking the proposals for underwriting commercial paper,<sup>94</sup> municipal revenue bonds, and 1-4 family mortgage-related securities.<sup>95</sup> Finally, the Board held that the public benefits of the proposals outweighed the possible adverse effects, provided that the activities were limited in scope and effect as provided in a rather extensive list of "firewall" restrictions set forth in the Board's opinion.<sup>96</sup> The Board emphasized that these limitations were "prudential" and that it believed it appropriate to "proceed cautiously" in view of the fact that the proposals "represent the first major entry of banking organizations into the field of underwriting and dealing in ineligible securities . . . ."<sup>97</sup> It warned that it might tinker with the limitations in the future.<sup>98</sup>

Chairman Volcker and Governor Angell dissented on the ground that bank-eligible securities were "securities" within the meaning of section 20. They emphasized that they agreed with the Board's decision as a policy matter, but believed that it contravened the intent of Congress underlying the Glass-Steagall Act:

The interpretation adopted by the majority would appear to make feasible, as a matter of law if not Board policy, the affiliations of banks with some of the principal underwriting firms or investment

<sup>92</sup> See *id.* at 478-81.

<sup>93</sup> See *id.* at 481-85.

<sup>94</sup> This issue had already been decided in the Chase Manhattan Corporation case. See *Chase Manhattan Corp.*, 73 Fed. Res. Bull. at 368.

<sup>95</sup> See *Citicorp/J.P. Morgan & Co./Bankers Trust*, 73 Fed. Res. Bull. at 487. The Board did not decide on the record before it whether consumer-receivable-related securities met the "closely related" test.

<sup>96</sup> See *id.* at 502-05.

<sup>97</sup> *Id.* at 504.

<sup>98</sup> See *id.*

houses of the country. Such a legal result, we feel, is inconsistent with the intent of Congress in passing the Glass-Steagall Act.<sup>99</sup>

The Board's decision in *Citicorp/J.P. Morgan & Co./Bankers Trust* represented a severe, although not entirely unexpected, setback to the Securities Industry Association. But that group had not been idle. Knowing that the Board was likely to approve further intrusions by banks into the securities business, the SIA had lobbied for, and obtained, a provision in banking legislation pending on Capitol Hill that would impose a moratorium on Board approval between March 6, 1987 and March 1, 1988 of any application which would permit a bank holding company to engage in the underwriting or public sale of securities on the basis that it was not "engaged principally" in such activity within the meaning of section 20 of the Glass-Steagall Act. The provision passed the Senate on March 27, 1987;<sup>100</sup> not coincidentally, the decision in *Chase Manhattan Corp.* came down on March 18, prior to the Senate's action but after the effective date of the proposed moratorium. This provision became § 201(b) of the Competitive Equality Banking Act of 1987.<sup>101</sup> Thus the securities industry had obtained at least a temporary reprieve from the depredations of the Federal Reserve Board.

The SIA then petitioned the Second Circuit for review of the Board's *Citicorp/J.P. Morgan & Co./Bankers Trust* order. The petition could have been taken up to the D.C. Circuit, but the SIA apparently concluded that its loss in *Bankers Trust II* did not auger well for future litigation in that forum. The Second Circuit, however, proved no more receptive, rejecting the SIA's petition in

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<sup>99</sup> *Id.* at 505.

<sup>100</sup> See S. 790, 100th Cong., 1st Sess., 133 CONG. REC. 4061, 4067 (1987).

<sup>101</sup> Pub. L. No. 100-86, § 201(b), 101 Stat. 552, 582-83 (to be codified at 12 U.S.C. § 1841). The provision states that between March 6, 1987 and March 1, 1988, [a] Federal banking agency may not authorize or allow by action, inaction, or otherwise any bank holding company or subsidiary or affiliate thereof . . . to engage in the United States to any extent whatever . . . in the flotation, underwriting, public sale, dealing in, or distribution of securities if that approval would require the agency to determine that the entity which would conduct such activities would not be engaged principally in such activities . . . ."

*Id.*

Section 202 of the statute permitted the Board to issue an order during the moratorium period pursuant to its pre-existing authority if the effective date of the order was delayed until the expiration of the moratorium. See *id.* at 584.

all respects in February 1988 (*Bankers Trust III*).<sup>102</sup> The Second Circuit reversed the Board only on its market share limitation—the subject of a cross-petition by the bank holding companies—finding no evidence that Congress intended to limit the activities of securities affiliates under section 20 through any market share test.<sup>103</sup>

Meanwhile the securities and banking industries made use of the one-year moratorium to fight a pitched battle on Capitol Hill over proposals to reform or repeal the Glass-Steagall Act. The securities industry's apparent strategy in obtaining the moratorium was to force the issue of Glass-Steagall reform onto the congressional agenda, and to obtain by legislation some sort of accommodation under which securities firms would be allowed into the banking business if banks were allowed into the securities business. This strategy seemed near success when the Chairperson and the ranking minority member of the Senate Banking Committee, Sen. William Proxmire and Sen. Jake Garn, proposed legislation that would have allowed banks to form securities affiliates and securities firms to form banking affiliates.<sup>104</sup> However, despite much activity, Congress was unable to agree on legislation and the moratorium expired.<sup>105</sup> The Board's orders remained in effect, however, although they had been stayed pending Supreme Court action on the SIA's petition for a writ of certiorari in *Bankers Trust III*. Members of Congress began to make statements, apparently at the behest of the securities industry, encouraging the Supreme Court to grant the writ of certiorari and imploring the Court not to draw any inferences from Congress's failure to act during the moratorium<sup>106</sup> or to assume that Congress would be able to resolve the

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<sup>102</sup> *Securities Indus. Ass'n v. Board of Governors of the Fed. Res. Sys.*, 839 F.2d 47 (2d Cir.), cert. denied, 486 U.S. 1059 (1988) [hereinafter *Bankers Trust III*].

<sup>103</sup> See *id.* at 67-68.

<sup>104</sup> See S. 1886, 100th Cong., 1st Sess., 133 CONG. REC. 16,659-67 (1987) (remarks of Sen. Proxmire) (outlining the text of the proposed act and stating that the legislation is necessary to modernize and constructively reshape our financial institutions).

<sup>105</sup> Seven bills to amend or repeal the Glass-Steagall Act were pending before the House Banking Committee at one time. The Chairperson of the Committee, Rep. St Germain, directed the staff to prepare a compromise committee draft, but the committee was unable to report out a bill. See 134 CONG. REC. E1,473 (daily ed. May 10, 1988) (remarks of Rep. Morrison).

<sup>106</sup> See 134 CONG. REC. E1,636-37 (daily ed. May 19, 1988) (remarks of Rep. Rinaldo); 134 CONG. REC. E1,473 (daily ed. May 10, 1988) (remarks of Rep. Morrison).

controversy at any time during the present geologic era.<sup>107</sup> The Supreme Court, unmoved, denied the writ.<sup>108</sup>

#### D. *Recent Developments*

At this point, the initial political battle over commercial paper was over. Banks and bank holding companies could place an unlimited amount of commercial paper for the accounts of issuers, and could underwrite commercial paper through a nonbank subsidiary up to the point where gross revenues from commercial paper underwriting and other bank-ineligible securities activities equalled five percent of the subsidiary's gross revenues. From a regulatory perspective, the battle now turned to the question of whether the prudential limits ("firewalls") on section 20 firms would be lifted, and if so, how soon.

The revenue limitation was not a serious constraint for large bank holding companies with subsidiaries that functioned as primary dealers in government securities. The amount of bank-eligible securities revenues brought in by these firms was so large that even very substantial underwriting was possible within the revenue cap.<sup>109</sup> The same was not true, however, for smaller or regional bank holding companies that did not control large primary dealers in government securities. These firms could operate section 20 subsidiaries only at a relatively low volume of business, a factor which as a practical matter meant that they could not operate

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<sup>107</sup> See 134 CONG. REC. E1,473 (daily ed. May 10, 1988) (remarks of Rep. Morrison) ("I hope the Supreme Court will not decline to grant review on the assumption that this Congress will enact legislation resolving the issues in the case. While this is what we should and perhaps can do, realistically speaking, the enactment of banking legislation in this Congress is very uncertain.").

<sup>108</sup> 486 U.S. 1059 (1988).

<sup>109</sup> See Garsson, *Limited Value Seen in Power to Underwrite*, AM. BANKER, Feb. 20, 1990, at 1 (noting that revenue limit has not proved a hindrance at Bankers Trust). Securities affiliates of big banks earn bank-eligible revenues through acting as primary dealers in Treasury securities, as well as through bank-eligible private placements which are likely to increase in number as a result of the newly-adopted SEC Rule 144A, Private Resales of Securities to Institutions, Securities Act Release No. 33-6862, Fed. Sec. L. Rep. (CCH) ¶ 84,523 (Apr. 30, 1990). This should greatly increase the attractiveness of private placements by allowing rapid development of a secondary market in privately placed securities. See Rehm, *Fed Expected to Ease Limit on Securities: Ruling Likely to Boost Underwriting Capacity*, AM. BANKER, Oct. 30, 1989, at 1. But see *Will the 144A Market Be Slow Off the Mark?*, INST. INVESTOR, May 1990, at 25 (noting that "now it looks as if [Rule 144A which] was touted as transforming the way capital is raised in the U.S. could take a while to lure significant members of issuers and investors").

section 20 securities subsidiaries at all.<sup>110</sup> When regional banks and bank holding companies made their unhappiness with this situation known,<sup>111</sup> the Board responded by raising the cap to ten percent, a level which should eventually allow a substantially larger number of bank holding companies to enter the securities business through section 20 subsidiaries.<sup>112</sup>

Bank holding companies also chafed under the prudential or "firewall" limitations applicable to transactions between the securities affiliate and the parent holding company. They claimed that some of these limitations were unnecessary and that compliance costs were high.<sup>113</sup> It is widely expected that the Board will reconsider its firewalls after an appropriate time in which the actual operations of section 20 subsidiaries can be observed.<sup>114</sup> At present, the stringency of the Board's firewalls is a matter of intense controversy within the banking and securities industries.

Finally, with respect to banks, the Board in 1989 issued an order allowing section 20 affiliates to underwrite and deal in corporate bonds, including junk bonds, and, after a waiting period, in corporate equity securities as well.<sup>115</sup> The D.C. Circuit upheld

<sup>110</sup> See Parisi interview, *supra* note 24; see also Garsson, *supra* note 109, at 1 (noting that except for large money-center banks, even large regional banks cannot generate enough bank-eligible revenue to make a profit in bank-ineligible activities).

<sup>111</sup> See Horowitz, *Fed May Expand Securities Powers*, AM. BANKER, Sept. 13, 1989, at 1, col. 1, 18, col. 3 (quoting an official of PNC Financial Corp., a regional bank holding company: "For a regional company of our size it doesn't make sense to engage in all four product lines [of bank-ineligible securities authorized by the Board] unless we can do a large amount in each particular line"); Horowitz, *Regionals Go Slow on Underwriting: They Let Money Center Banks Take the Lead on Section 20*, AM. BANKER, Aug. 29, 1989, at 5; Rehm, *Bank Victories on Securities Mostly Symbolic*, AM. BANKER, Apr. 12, 1990, at 1, 13 (discussing Security Pacific Corp., a large regional bank, which has yet to implement its securities powers because of the burdens of firewall restrictions).

<sup>112</sup> See *Modifications to Section 20 Orders*, 75 Fed. Res. Bull. 751 (1989).

<sup>113</sup> See, e.g., Garsson, *supra*, note 109, at 1, col. 1 (noting that Bankers Trust was forced to move clearing operation for non-Treasury securities out of its securities affiliate because of firewall prohibiting loans between insured banks and securities affiliate).

<sup>114</sup> The Board expressly indicated that it might revisit and revise the firewalls in the future. See Citicorp/J.P. Morgan & Co./Bankers Trust, 73 Fed. Res. Bull. 473, 504-05 (1987).

<sup>115</sup> See J.P. Morgan & Co., Inc., 75 Fed. Res. Bull. 192 (1989). The Board's action was apparently taken with careful attention to its political consequences. As to bond underwriting, the Board was well aware that many potential opponents of expanded bank powers had voted during the previous year to allow banks to underwrite corporate bonds; those members were thus hampered in their ability to complain when the Board accomplished the same result by regulation. As to equity underwrit-

this order in April 1990.<sup>116</sup> Thus, banks are now able, through their securities affiliates, to engage in a wide range of securities activities, subject to the requirement that the gross revenues from the bank-ineligible activities not exceed ten percent of the affiliate's total revenues, and subject also to the various firewalls against transactions between securities affiliates and other parts of the bank holding company. The securities affiliates of banks live again—despite the nearly universal belief for nearly a half-century that they had been forever destroyed by the Glass-Steagall Act of 1933.

Securities firms, for their part, have faced still further difficulties over the past few years. First, the legal developments which have allowed bank affiliates to underwrite securities have not benefitted them. All the major securities firms are “engaged principally” in bank-ineligible activities. Accordingly, they cannot affiliate with banking institutions by setting themselves up as section 20 subsidiaries of bank holding companies. Nor, under section 21, can they engage “to any extent whatever” in deposit banking either directly or through a subsidiary. In short, while the Glass-Steagall Act has proved to be relatively toothless when applied to securities activities by big bank holding companies, it retains a great deal of bite as applied to banking activities by the big securities firms.

This suggests that the value of the Glass-Steagall Act in protecting securities firms against bank competition may have been eroded to the point where the securities industry as a whole might not be severely damaged by repeal of the Act. In May 1990, the Securities Industry Association took the fateful step of dropping its opposition to repeal of the Glass-Steagall Act.<sup>117</sup> The United States appears

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ing, the Board, while approving the activity itself, announced that it would not grant any actual approvals for a year. This deferral ostensibly allowed Congress a period of time in which to reverse the Board, thus deflecting potential congressional criticism. Given the paralysis that Congress has displayed on Glass-Steagall issues, few observers seriously believed that Congress would reverse the Board's order. See Rehm, *Fed Ruling Leaves Congress Leeway*, AM. BANKER, Jan. 20, 1989, at 1, 16. As expected, Congress took no action.

<sup>116</sup> See *Securities Indus. Ass'n v. Board of Governors of the Fed. Res. Sys.*, 900 F.2d 360 (D.C. Cir 1990) [hereinafter *Bankers Trust IV*]. The Court held that, having lost on essentially the same arguments in the Second Circuit in *Bankers Trust III*, 839 F.2d 47, *cert. denied*, 486 U.S. 1059 (1988), the SIA was estopped from relitigating the issue in the D.C. Circuit.

For a discussion of the potentially greater implications of the Fed's recent decision to allow commercial banks to underwrite securities, see Sease, *supra* note 12, at C1, col. 5.

<sup>117</sup> See *Securities Industry Accepts Glass-Steagall is Doomed*, FIN. TIMES INT'L BANKING REP., June 1990.

to be taking the first groping steps towards a European-style system of universal banking in which a single organization offers a full array of banking, securities, and other financial services.

As a result of the developments recounted above, much of the conflict between banks and securities firms has now been redirected from the political to the marketplace arena. It was one thing for bank holding companies to achieve the formal power to engage in securities underwriting; it is quite another to establish a section 20 underwriting affiliate able to compete on equal terms with established securities firms. Moreover, the securities industry itself recently has faced a series of painful shocks, including the market break of October 1987, the slowdown in corporate takeover activity starting in 1988, the bankruptcy of Drexel Burnham Lambert in late 1989, the ensuing collapse of the junk bond market, and the downturn in the stock market stimulated by the Iraqi invasion of Kuwait. Profits of securities firms were down, and a number of firms had to lay off employees in 1990. Given these developments, it is hardly surprising that a number of bank holding companies that obtained permission to open section 20 subsidiaries have not yet done so, apparently out of concern that they can not compete in an already packed market.<sup>118</sup> One bank holding company closed its section 20 affiliate only two years after its creation.<sup>119</sup> Those that continue to operate section 20 subsidiaries have focused their business almost exclusively in the area of commercial paper.<sup>120</sup>

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<sup>118</sup> See GAO Report: "Bank Powers: Activities of Securities Subsidiaries of Bank Holding Companies," *Hearings Before the Subcomm. on General Oversight and Investigations of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 2d Sess. 106 (1990) [hereinafter GAO Report] (as of September 30, 1989, 21 holding company subsidiaries had received permission to conduct bank-ineligible activities, but only 13 had actually commenced such activities).

<sup>119</sup> See Leander, *Bank of Boston Closes Sec. 20 Unit*, AM. BANKER, June 5, 1990, at 2.

<sup>120</sup> See GAO Report *supra* note 118, at 60-61. Commercial paper represented approximately 98% of bank-ineligible activities by § 20 firms between the third quarter 1988 and the third quarter 1989. For example, in the third quarter of 1989, § 20 affiliates underwrote \$386 million in municipal revenue bonds, \$600 million in mortgage-related securities, \$45 million in asset-backed securities, and \$67,660 million in commercial paper. See *id.* Although a number of § 20 firms had announced plans to enter the junk bond field, as of May 1990 none had done so. See Smith, *Banks See Golden Opportunity in Junk*, Wall St. J., May 15, 1990, at C1, col. 3. In June 1990, Citicorp announced that it was terminating its municipal securities underwriting business. See Guenther, *Citicorp Will End Its Underwriting of Municipal Issues*, Wall St. J., June 5, 1990, at C21, col. 1.



It is not yet clear whether section 20 firms will be able to survive in the highly competitive commercial paper market. Market participants we interviewed said that spreads were so low in 1989 that it was very difficult to make a profit in commercial paper underwriting.<sup>121</sup> An officer at Merrill Lynch Capital Markets estimated that in the spring of 1989 the three leading section 20 firms, BT Securities Corp. (the Bankers Trust New York Corporation subsidiary), Citicorp Securities Markets, Inc., and J.P. Morgan Securities, Inc., each had approximately \$15 billion outstanding in commercial paper underwritings, while the break-even point for this business was approximately \$28 billion.<sup>122</sup> The section 20 firms were almost certainly operating at a loss during this period.

Although section 20 firms may not yet be turning a profit, the trend for bank commercial paper underwriting has been dramatically positive, with total commercial paper underwritten by section 20 firms rising from approximately \$12 billion in the third quarter of 1988 to approximately \$68 billion in the third quarter 1989.<sup>123</sup> Recent press accounts indicate that banks continue to do well in this field.<sup>124</sup> Banks such as Bankers Trust and Citicorp show every sign of being committed to the commercial paper market for the long haul, both as a means of gaining an initial toehold in the securities business and as a device for maintaining and enhancing contact with their prime commercial customers.<sup>125</sup> In short, there can be little doubt that the government decision to permit commercial banks to enter the commercial paper market had a significant economic impact.

<sup>121</sup> See Fuscone & Smithwick interview, *supra* note 38; Parisi interview, *supra* note 24. Spreads have been low for a number of years, forcing major players such as Salomon Brothers and Paine Webber to abandon the business. See Tobin, *Players Reshuffled in CP Market*, *EUROMONEY*, June 1988, at 175.

<sup>122</sup> See Parisi interview, *supra* note 24.

<sup>123</sup> See GAO Report, *supra* note 118, at 106; see also, Quint, *Turning the Tables*, *U.S. BANKER*, July 1988, at 14 (1988) (reporting the growing number of banks successfully entering the commercial paper market).

<sup>124</sup> See Tobin, *supra* note 121, at 175; Neustadt, *supra* note 38, at 1, col. 4.

<sup>125</sup> See Rehm, *supra* note 111, at 1, col. 1 (reporting that NCNB Corp., a large regional bank holding company, decided to activate a securities affiliate because, over time, the value of bank powers will grow, and because NCNB wanted to obtain grandfather rights in the event that Congress chose to bar further investment banking affiliates); see also Garsson, *supra* note 109, at 1, col. 1 (noting that the most important aspect of new bank powers is that banks have "an opportunity to become familiar with corporate debt and equity underwriting in anticipation of full-scale repeal of the Glass-Steagall Act").

### III. THE JAPANESE EXPERIENCE

#### A. *The Controversy in the Diet*

As previously discussed, commercial paper did not exist in Japan prior to the recent controversy. In fact, the essence of the controversy was not the question of who would control the commercial paper market, as it was in the United States, but rather whether a commercial paper market should exist at all. Once this question was raised, however, the conflict between banks and securities firms quickly came to the forefront.

That conflict, although built into the structure of the Japanese financial services industry by the Securities Exchange Law (SEL) and its article 65, had long remained dormant. The Tokyo Stock Exchange was bombed into ruins during World War II and had yet to reopen in 1948, the time of the SEL's passage. Banks were preoccupied by efforts to stay afloat given the massive damage that the war had caused. With the general revival of the economy and the banking sector during the Korean War boom, the banks began to flourish and became the main suppliers of funds to Japan's ever-expanding industrial sector. Throughout the high-growth era, banks were highly profitable relative to the rest of Japanese industry as they were able to enjoy the fruits of their regulated market. The underdeveloped securities market offered few temptations.

In the 1970s, however, changes in the Japanese economy began to destabilize the balance between banks and securities firms.<sup>126</sup> Perhaps the most significant change was the gradual erosion of the banks' most lucrative form of business—providing credit to Japanese industrial firms. In a mature economy, these firms were no longer as desperate for credit as they had been previously. Some, such as Toyota, amassed huge amounts of surplus cash, and, insulated from the threat of hostile takeovers, used this cash to finance themselves, rather than distributing it to shareholders. Others took advantage of new ways to raise capital that were more flexible and less expensive than bank loans, such as issuing convertible bonds or selling securities in the newly-accessible Euromarket.

A second problem for commercial banks, of a more technical but still significant nature, came in the area of government bonds. Government bonds had historically been underwritten by syndicates of commercial banks, with resales forbidden. Banks were willing to

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<sup>126</sup> See F. ROSENBLUTH, *supra* note 28, at 4.

underwrite the bonds despite their low interest rates because the Bank of Japan would buy them up in open market operations soon after issuance, in order to expand gradually the money supply. The system broke down, however, when the Japanese government began to issue a huge volume of deficit-finance bonds in 1976-77. The Bank of Japan could no longer purchase all or even most of the bonds, as such purchases would have resulted in an inflationary overexpansion of the money supply. Left holding large, unprofitable government bond portfolios, the banks demanded the ability to sell these bonds to the general public. There followed a lengthy debate involving the banking and securities industries, the MOF, and the ruling Liberal Democratic Party (LDP). This debate set the tone and much of the agenda for the banking-securities conflicts that have taken place since.<sup>127</sup> In the end, major Securities and Exchange Law and Banking Law revisions in 1981 allowed banks to sell government bonds to the public.

During negotiations involving the 1981 Banking Law and Securities and Exchange Law revisions, the securities industry raised the commercial paper issue with the MOF. The banks opposed commercial paper out of well-grounded fear that commercial paper would further reduce their control of the market for corporate finance. In addition, banks and other interested parties (including the MOF) apparently expected that if commercial paper were to be authorized, it would be through designation as a security,<sup>128</sup> and that banks would be excluded from the market. This expectation was partially based on the situation in the U.S., the birthplace of article 65, where banks had only recently attempted to enter the commercial paper business and challenge the assumption that commercial paper was a security. In addition, foreign commercial paper had been designated a security under the Foreign Exchange and Foreign Trade Control Law (FECL) of 1979,<sup>129</sup> which had partially liberalized the movement of capital in and out of Japan.

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<sup>127</sup> The details of this debate are recounted in J. HORNE, *JAPAN'S FINANCIAL MARKETS: CONFLICT AND CONSENSUS IN POLICYMAKING* 98-117 (1985), and F. ROSENBLUTH, *supra* note 28, at 128-36 (1989).

<sup>128</sup> Commercial paper could have been designated a security either by amendment to the Securities and Exchange Law, by a Cabinet Order as contemplated by Securities and Exchange Law, art. 2, § 1, cl. 9, or by a MOF interpretive decision that commercial paper would be treated as falling within one of the existing categories of securities, most likely as an unsecured corporate debenture.

<sup>129</sup> Gaikoku Kawase oyobi Gaikoku Boeki Kanri Ho, Law No. 8 of 1960, as amended by Law No. 65 of 1979 (all untranslated Japanese sources are on file with the authors, who have supplied the corresponding references).

In arguing for their position, the banks raised the following policy concerns:

(1) Commercial paper would undermine the traditional rule requiring collateral for Japanese debt financing. Japanese finance was based on the idea that strict collateral requirements would control against losses in the event of default and thereby guarantee the stability of the financial system. Since commercial paper would depart from this principle, introduction without adequate study would endanger investors and raise the potential for chaos in the financial markets.

(2) Commercial paper would weaken the "main bank" system, by which one bank acts as a corporation's principal financial adviser and lender. The "main bank" system had played an important role in Japanese finance, but would be undermined if corporations were to raise funds directly from open money markets.

(3) Commercial paper was a uniquely American product, necessary in the United States because of the absence of interstate banking and because of strict limits on bank loans to individual customers. In Japan, banks had proven able to supply ample short-term finance at low interest rates, eliminating any need for commercial paper.<sup>130</sup>

Others argued that a commercial paper market would reduce the effectiveness of Bank of Japan "window guidance," a leading tool of monetary policy,<sup>131</sup> and would lead to the collapse of the system of regulated interest rates.<sup>132</sup> The MOF refused to act in the face of bank opposition, citing as its reason the lack of issuer demand for commercial paper given ample availability of bank financing at low, regulated rates of interest.

The securities industry was not satisfied with this result, and it apparently asked members of the governing LDP to introduce an advisory resolution in the national legislature, the Diet.<sup>133</sup> The

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<sup>130</sup> See T. AMAYA, *UGOKIDASHITA* CP 75-77 (1988) (listing bank arguments). The author of this book is a junior MOF official and served in MOF's Securities Bureau, Capital Markets Section during the period of commercial paper's introduction. The book is representative of MOF views.

<sup>131</sup> "Window guidance" refers to the Bank of Japan setting a specific quantitative ceiling on the aggregate lending of each bank. It is used only during periods of tight money and has the benefit of being a very precise control on the amount of credit in the economy. See Ackley & Ishi, *Fiscal, Monetary and Related Policies*, in *ASIA'S NEW GIANT: HOW THE JAPANESE ECONOMY WORKS* 153, 202-04 (H. Patrick & H. Rosovsky eds. 1976).

<sup>132</sup> *Daiki-shoki: Komāsharu pēpā*, *Nihon Keizai Shinbun* (Financial Column), May 31, 1985, at 17 [hereinafter *Daiki-shoki*, May 31, 1985].

<sup>133</sup> This resolution supported the demands of the securities industry, and yet our

Finance Committee of the House of Representatives passed such an advisory resolution stating that "in order to advance internationalization and the diversification of financial products, the legal and practical aspects of introducing commercial paper should be studied."<sup>134</sup> The resolution was plainly directed at the MOF, since the commercial paper question was under its banking and securities regulation jurisdiction. This one-sentence advisory resolution is the only evidence of Diet involvement in the decision to introduce commercial paper, and it appears to have had little or no impact on the final decision. The MOF took no action in response to it, having already determined not to act on commercial paper at that time. When the MOF did act after five years, it did so for reasons entirely unrelated to the resolution.<sup>135</sup>

The Ministry's steadfastness in the face of pressure from the legislature is not surprising. While in theory the Diet has great power over the MOF, in practice the relationship between the MOF and the Diet is almost the reverse. The MOF has long been the dominant forum for decisions over financial services. Resort to the Diet usually takes place at the MOF's behest, when a desired policy change cannot be implemented under the existing statutes.

One reason for this custom is that the Diet lacks the staff, expertise, or prestige to pass legislation significantly interfering with the MOF's freedom of action. Japan has a long tradition of the best and brightest students entering the government ministries, particularly the MOF. The MOF recruits heavily from the Law Faculty of the University of Tokyo, and takes the undisputed cream of the crop, the top of the clearly defined Japanese educational

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interviews with key participants in the process left us uncertain as to its actual origin. One possibility is that the MOF favored early introduction of commercial paper, but was unable to overcome strong bank opposition. If that were the case, the MOF may have acquiesced in or even indirectly sponsored the Diet resolution. The resolution was vague enough so as not to unduly restrict future MOF action, yet specific enough to provide MOF a basis for later reviving the commercial paper debate with the banks. We believe, however, that the evidence points to a source within the securities industry.

<sup>134</sup> Japanese Diet, House of Representatives, Finance Committee Advisory Resolution (*Okura iinkai no futai ketsugi*) (May 13, 1981), reprinted in T. AMAYA, *supra* note 130, at 68.

<sup>135</sup> The question of relations between the Diet and the ministries is an extremely sensitive one. While the MOF officials we interviewed were quite open and forthcoming about relationships within the MOF and with interest groups, they would speak about the Diet in only the most general terms. Of course, this relationship involves the senior MOF officials.

hierarchy. The Diet, in contrast, has few specialists, and its staff consists largely of privately-funded political workers.<sup>136</sup>

Moreover, in Japan's highly regulated system, MOF decisions over the powers and activities of the banking and securities industries are ongoing, since individual firms need the MOF's permission to receive licenses or to undertake numerous transactions. It is in the interests of both the banking and securities industries to keep these decisions in a single forum, so as to ensure even-handedness and predictability. If the MOF were to sacrifice bank interests to the interests of issuers, investors, or securities firms in making one decision, the banks would be in a position to demand assurance of favorable consideration when the next decision arises. As a consequence, the banks and securities firms are able to "bargain" through the MOF, and attempt to find mutually advantageous solutions on a range of issues. The banking and securities industries have extensive experience dealing with the MOF and they recognize it is often in their best interests to accept its decisions. Thus, the MOF can make compromises, and, unlike U.S. administrative agencies, it can enforce those compromises without fear of litigation or effective after-the-fact legislative opposition from either industries within the MOF's jurisdiction or unrepresented interest groups. If the securities firms were to have taken the commercial paper issue to the Diet, not only would they have had no assurance of fair treatment, but they would have had no way of knowing how the Diet would respond, whether other issues would be raised or traded off in response, or whether an unfavorable result could be compensated for in the future. A bidding war for influence in the Diet on a single issue would not have assisted either the banks or securities firms in the process of ongoing regulatory decisions.

Finally, all the participants in the commercial paper struggle—banks, securities firms, and issuers—were constituents of the conservative, business-oriented LDP. The LDP's best strategy was to defer the decision to the MOF, rather than risk a political battle. Moreover, the Diet contains representatives of opposition parties as well as of the LDP. Since the LDP, as the ruling party, is closely allied with the bureaucracy, a shift of resources to the Diet would only serve to empower the opposition parties by bringing them into

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<sup>136</sup> See, e.g., J. HORNE, *supra* note 127, at 193-98 (describing career patterns at the MOF).

the debate, and would diminish the ultimate control exercised by LDP constituencies.<sup>137</sup>

Although the 1981 Diet resolution did not induce the MOF to act, issuer and securities interests made one further effort to move the debate forward. In 1982, the commercial paper issue was taken up in the Industrial Structure Council of the Ministry of International Trade and Industry (MITI).<sup>138</sup> MITI has authority over the manufacturing industry generally, as well as the trading companies who were expected to (and have in fact) become the largest issuers of commercial paper. It generally represents the concerns of its industrial constituency in interagency debates and could be expected to lobby on their behalf. But bank representatives also sat as members of MITI's Industrial Structure Council, and their strong opposition to commercial paper led the Council to issue a final report citing divided opinion over the commercial paper issue.<sup>139</sup> This inconclusive result, and the feeling that it would be fruitless to continue discussion without the participation of the MOF given its primary jurisdiction over banking and securities regulation, led MITI to drop the issue.<sup>140</sup> Thus, the first round ended with the MOF refusing to act, and two efforts to circumvent its authority coming to naught.

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<sup>137</sup> For this reason, when the Diet does become involved, the meaningful debate often takes place not in the formal Diet committees, but in the LDP's party committees. The opposition parties have not taken advantage of the apparent opportunities to gain support from consumers of financial services by opposing MOF and LDP positions.

<sup>138</sup> The Industrial Structure Council is one of the MITI's standing advisory councils, or *shingikai*. These councils provide formal advice to the ministries. Their membership is chosen by the relevant ministry, and generally includes industry representatives, academics, journalists, elder statesmen, and even an occasional consumer advocate. They meet regularly, receive presentations from ministry officials, and are consulted as proposals are prepared.

*Shingikai* provide a check on agency action, as legislative or regulatory proposals generally do not go forward without the approval of the relevant *shingikai*, and the *shingikai* operate based upon consensus. Perhaps equally important, the *shingikai* legitimize bureaucratic decisions by giving them the imprimatur of a group of respected citizens outside the bureaucracy.

Formal standing *shingikai*, created by statute, advise either individual bureaus or entire ministries. When useful to the bureaucracy, ad hoc *shingikai* have been formed to study particular issues, or to provide viewpoints which the standing *shingikai* do not support. The commercial paper case provides one example of the various *shingikai* in operation.

<sup>139</sup> See T. AMAYA, *supra* note 130, at 68; *Daiki-Shoki* May 31, 1985, *supra* note 132, at 17.

<sup>140</sup> See Interview with Yoshiaki Koyama, Director, Research Division, Banking Bureau of the MOF, and with other MOF officials in Tokyo (June 24, 1988).

B. *The Changing Landscape: Financial Liberalization  
from 1982 to 1985*

After these events, little further formal discussion concerning the introduction of commercial paper took place until early 1986. In this interval, however, the environment in which the commercial paper debate took place changed drastically.

Japan had undergone gradual financial liberalization since the late 1970s, including revisions of the FECL in 1979<sup>141</sup> and the Banking Law in 1981,<sup>142</sup> and numerous regulatory changes instituted by the MOF. New financial markets had opened up as regulators and regulated parties alike determined to make Tokyo an international financial center. Banks were allowed to issue negotiable certificates of deposit in 1979; this new market quickly joined the call, bill discount, and *gensaki* markets as one of the principal short-term money markets. The 1981 Banking Law clearly defined bank powers to deal in government bonds, and retail sales of public bonds by banks began in April 1983. The system of regulated interest rates came under pressure from new, market-rate products, as liberalization of foreign exchange rules gave large borrowers and investors a way around the regulated domestic markets, and new domestic products such as money market certificates were introduced.

Liberalization proceeded slowly, however, due to a lack of regulatory momentum. This momentum was soon provided by foreign pressure (referred to in Japanese by the term *gaiatsu*). During 1982 to 1984, the U.S. global trade deficit and the bilateral deficit with Japan reached unprecedented levels.<sup>143</sup> Part of the blame for U.S. trade performance fell on the strong dollar and weak yen, a phenomenon that might have been explained by high interest rates brought on in part by the U.S. federal government budget deficit, but which some U.S. officials preferred to attribute to closed, regulated Japanese financial markets that depressed demand for the yen and increased demand for the dollar, and even to market manipulation by a mysterious Japanese conspiracy. This supposed link between restricted Japanese financial markets, an

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<sup>141</sup> See J. HORNE, *supra* note 127, at 153-64.

<sup>142</sup> See *id.* at 107-12.

<sup>143</sup> See KEIZAI KOHO CENTER, JAPAN INSTITUTE FOR SOCIAL AND ECONOMIC AFFAIRS, "JAPAN 1985: AN INTERNATIONAL COMPARISON" 48 (1985).



overvalued dollar, and poor U.S. trade performance led to U.S. demands for Japanese financial liberalization.<sup>144</sup>

Financial liberalization received top priority during President Reagan and Treasury Secretary Regan's visit to Japan in November of 1983. A joint U.S.-Japanese press statement listed eight areas of potential liberalization and announced that MOF and the Treasury Department would establish a Working Group on Yen/Dollar Exchange Rate Issues. The Working Group met during the Spring of 1984, and on May 29, 1984 issued a report detailing a variety of deregulatory measures.<sup>145</sup> One result of this activity was to revive the debate on whether Japan should authorize a domestic commercial paper market.

Although U.S. demands appear to have acted as the catalyst for this chapter of Japanese financial deregulation, the influence of domestic interests favoring deregulation should not be underestimated. These interests welcomed foreign pressure that would help them achieve their goals. Japan has a long tradition of domestic groups using foreign pressure to serve their interests, going back to the time Commodore Perry forced Japan open to the outside world. In the commercial paper case, the large banks and securities firms faced slowly declining benefits from the old system of regulation, and saw great opportunities from deregulation and the emergence of Tokyo as an international financial center. The smaller, less competitive financial institutions and other interests favoring the status quo would have vetoed such change under normal circumstances. By overriding such opposition, the foreign pressure tipped the scales in favor of accelerated liberalization. Once the Yen/Dollar discussions had begun, the MOF quickly prepared a report that covered other liberalization measures, and released it contemporaneously with the Yen/Dollar Report.

During the period up to 1984, one aspect of the debate over financial liberalization which provided an important precedent for domestic commercial paper was the decision to allow sales of foreign commercial paper to investors in Japan. The participation of banks and securities firms in these sales was much discussed. The 1979 revision of the FECL relaxed the regulation of monetary

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<sup>144</sup> See, e.g., F. ROSENBLUTH, *supra* note 28, at 50-95 (discussing foreign pressure for liberalization); KINYŪ JIYŪKA TO EN NO KOKUSAIKA 79-95 (Kinyū Zaisei Jijō Kenkyūkai ed. 1985) (recounting events leading up to the establishment of the Yen/Dollar Working Group, and the various proposals put forward by that group).

<sup>145</sup> For a discussion of the Regan visit, see F. ROSENBLUTH, *supra* note 28, at 73-75.

flows in and out of Japan and raised the possibility that, when the proper regulations had been promulgated, Japanese investors could purchase foreign commercial paper and other short-term financial instruments. The revised FECL defined "security" by a list of traditional securities similar to that in the SEL, and, also as in the SEL, allowed for designation of other instruments as securities by Cabinet Order. The MOF used this catch-all provision of the FECL's security definition to designate foreign commercial paper a security for purposes of the FECL. The securities firms asked the MOF to designate similarly foreign commercial paper a security under the SEL, which, pursuant to article 65, would have excluded banks from sales of foreign commercial paper in Japan. But the banks lobbied successfully for equal participation in sales of foreign commercial paper. The MOF completed draft rules for foreign commercial paper sales in 1982.

In the end, introduction of foreign commercial paper was delayed because of bank unhappiness over the plans of securities firms to sell foreign commercial paper that performed as if it were yen-denominated commercial paper, and thereby to hedge exchange risk. Banks saw such a yen-based instrument as direct competition for their large-scale domestic deposits and a threat to their control over short-term money markets. After the U.S. pressure for liberalization increased, the MOF finally arrived at a compromise between the two industries. On April 1, 1984, the foreign commercial paper sales went forward under the 1982 rules, with the exception that securities firms were required to maintain special accounts with authorized foreign exchange banks in order to receive payments.<sup>146</sup> This special account requirement gave banks a share of the business, even if it was unnecessary for providing adequate service or investor protection.<sup>147</sup>

One final change between 1981 and 1986 occurred not in Japan but in Europe. France, England, and the Netherlands all responded

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<sup>146</sup> See, T. AMAYA, *supra* note 130, at 55-61 (describing details leading up to the opening of sales of foreign commercial paper).

<sup>147</sup> Other decisions regarding bank-securities firm competition were made during this period. In March 1985, MOF negotiated an agreement involving entry into several new areas of business. Banks were allowed to become full dealers of government bonds, and to enter the market for bond futures. Securities firms were allowed to trade CDs, and to intermediate transactions in yen-based bankers acceptances (BA). The banks were said to have gotten the better of this deal. See *CP Dōnyū to Chūkoku F no Shohin Kaizen ga Nihonbashira*, Kinyū Zaisei Jijō, Feb. 10, 1986, at 34-35.

to the growth of Euro-commercial paper markets by establishing domestic commercial paper markets during 1985 and early 1986. These new European markets may have influenced the decision to establish a commercial paper market in Japan in several ways.

First, the banks had argued in 1981 that commercial paper was unsuited to the unique Japanese financial system. Commercial paper could be considered an American aberration, a product made necessary because of the United States' fragmented interstate banking system and used mainly by the United States' proliferating non-bank financial service companies. Domestic Japanese liberalization, with the prospect of further deregulation of interest rates and financial products, had made the Japanese financial system seem less unique by 1986. The rapid growth of Euro-commercial paper and introduction of domestic commercial paper markets in Europe eliminated any argument that commercial paper was an American aberration.

More substantively, the desire that Tokyo become a competitive financial center, and the deep-seated fear of being left behind by western competitors, made the introduction of commercial paper in major European markets an incentive for similar action in Japan. These markets also proved useful models for those in Japan who were considering what shape a Japanese market would take. Writings on the introduction of commercial paper in Japan display keen awareness of the new European markets.<sup>148</sup>

### C. *The Commercial Paper Debate Resurfaces*

The commercial paper issue resurfaced in early 1986 when *Keidanren*<sup>149</sup> established a Capital Markets Group to study introduction of commercial paper.<sup>150</sup> Banks are represented in *Keidanren*, as they had been in MITI's Industrial Structure Council during that group's 1982 discussion. But the banks did not actively oppose introduction of commercial paper in *Keidanren*.<sup>151</sup> Japan's leading financial newspaper, *Nihon Keizai Shinbun*, explained that

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<sup>148</sup> See T. AMAYA, *supra* note 130, at 36-43; Y. KAWAMURA, CP=KOMĀSHARU PĒPĀ (CP=Commercial Paper) 113-37 (1987).

<sup>149</sup> *Keidanren* is the Federation of Economic Organizations, roughly analogous to the U.S. Chamber of Commerce but far more influential. It represents Japanese big business on matters of public policy, among other activities.

<sup>150</sup> See Y. KAWAMURA, *supra* note 148, at 160 (noting the establishment of the Capital Markets Group).

<sup>151</sup> See CP, *Togin mo Dōnyū Kiun*, *Nihon Keizai Shinbun*, May 28, 1986, at 1 [hereinafter *Nihon Keizai Shinbun*, May 28, 1986].

the Chairmen of Fuji and Sumitomo Banks had been appointed *Keidanren* Vice-Chairmen and, in these positions of responsibility, needed to act impartially and consider the requests of the group as a whole, leaving banking concerns without an advocate. In the end, no banking or securities representatives were included in the Capital Markets Group, so that the group would focus on the needs of issuers instead of the interests of the two industries.<sup>152</sup> Not surprisingly, the result was that the Group recommended early introduction of commercial paper.<sup>153</sup>

By late March 1986 the *Nihon Keizai Shinbun* recognized that the commercial paper question was becoming a hot policy topic. A *Nihon Keizai* financial column came out repeatedly in favor of introducing commercial paper, claiming that three changes since 1981 had made the Japanese financial system a more hospitable environment for commercial paper. First, unsecured debt financing in Japan had become far more widespread than in 1981, with relaxation of MOF regulations on the issue of bonds without collateral. Second, bond rating agencies along the lines of Moody's Investor's Service and Standard & Poor's Corporation had been introduced into Japan, promising to make unsecured corporate debt a less risky, more marketable product. Third, the MOF had continued along a path of gradual deregulation of interest rates, replacing some regulated rates and credit rationing with a market in which commercial paper could be a competitive product.<sup>154</sup>

Securities industry representatives suggested that issuer demands for a commercial paper market should be satisfied.<sup>155</sup> In May 1986, the Japan Securities Industry Association announced its own commercial paper proposal. The main features were (1) commercial paper would be introduced; (2) it would be treated as a promissory note rather than a security; (3) underwriting and trading would be limited to securities firms; (4) bank back-up lines would be mandatory; and (5) banks would be used as payment agents.<sup>156</sup> Independent observers criticized the proposal as

<sup>152</sup> See *id.*

<sup>153</sup> See *id.*

<sup>154</sup> See *Daiki-Shoki: CP no Sōsetsu ga Isoge*, *Nihon Keizai Shinbun*, Mar. 29, 1986, at 15; *Daiki-Shoki: Ki ga Nessuru CP Dōnyū Rongi*, *Nihon Keizai Shinbun*, July 10, 1985, at 17; *Daiki-Shoki: Komāsharu Pēpā*, *Nihon Keizai Shinbun*, May 31, 1985, at 17.

<sup>155</sup> See *Yūzā o Fukumeta Rokujyūgyōron o Tenkai Shiyō*, *Kinyū Zaisei Jijō*, Feb. 10, 1986, at 30-32 (Interview with Mr. Chino, Chairman, Japan Securities Industry Association).

<sup>156</sup> See *CP Hakkō Tegata Hōshiki*, *Nihon Keizai Shinbun*, May 16, 1986, at 1. The

carving up the market, giving the securities firms the lion's share of the business but requiring mandatory bank back-up lines and using banks as payment agents. In that sense, it provided a nod in the direction of banks, while ignoring the interests of issuers.<sup>157</sup> The securities firms presented their proposal to the MOF and the MOF Securities Bureau's standing advisory council, the Securities Transactions Council. At nearly the same time, the Bond Underwriters Association (another securities industry group) announced a survey of issuers showing widespread support in industrial circles for introduction of commercial paper.<sup>158</sup>

These actions by *Keidanren* and the securities industry signaled widespread interest in commercial paper and support for its eventual introduction. *Nihon Keizai Shinbun* hinted that if the banks did not shift their stance on commercial paper, they would lose the chance to influence the details of the commercial paper market and maybe lose the chance to participate in the market, as the securities industry proposal would exclude banks.<sup>159</sup> These developments necessitated some kind of bank response.

The major banks considered the issue again during the summer at the July 1986 City Bank Roundtable (*toshiginkō konwakai*). There was no formal or announced change in bank opposition to commercial paper. Bankers continued to insist on the need for further study of experience abroad with commercial paper. Likewise, they cited recent failure of the newly established market in yen-based bankers' acceptances as evidence that short-term financial markets were not yet mature enough to support a commercial paper market.<sup>160</sup>

Nevertheless, bank opposition appeared to weaken. Some banks changed their positions, recognizing that banks' traditional lending to corporate customers had become less profitable as the biggest corporations could gain access to capital markets directly. Within the major banks, those departments interested in expanding their

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proposal was a result of a series of meetings of vice presidents of the Big Four securities firms, beginning in March 1986. See *Kokunai CP Ronsō ni Kōshi o Ita "Shōkenshian" no Hamon*, Kinyū Zaisei Jijō, June 2, 1986, at 14.

<sup>157</sup> See *Kokunai CP Ronsō ni Kōshi o Ita "Shōkenshian" no Hamon*, *supra* note 156.

<sup>158</sup> See *CP Dōnyū ni Kigyō wa Sekkyokuteki*, *Nihon Keizai Shinbun*, May 10, 1986, at 13.

<sup>159</sup> See *Nihon Keizai Shinbun*, May 28, 1986, *supra* note 151, at 1.

<sup>160</sup> See *Daiki-Shoki: Konomareru CP Yūzō An*, *Nihon Keizai Shinbun*, Aug. 1, 1986, at 17; *Kokunai CP: Shichigatsu Reikai made ni "Kangaekata" o Sakusei*, Kinyū Zaisei Jijō, July 7, 1986, at 32 [hereinafter Kinyū Zaisei Jijō, July 7, 1986].

securities activities began to look upon commercial paper as a possible business opportunity. This was partially a result of the record profits Japanese securities firms were making at the time, and of the growth of the Tokyo securities markets. But Japanese bankers also were acutely aware of the Bankers' Trust litigation in the United States,<sup>161</sup> which was reported regularly in the Japanese financial press, as well as of the intense lobbying in the United States for abolition of Glass-Steagall. There were at least some reports that the efforts of U.S. banks to enter the commercial paper market led Japanese banks to see commercial paper as a new business opportunity.<sup>162</sup>

Now the banks' first priority was not to foreclose a commercial paper market entirely but to "stop the rogue securities industry proposal."<sup>163</sup> Bank opposition did not formally end until after the internal MOF compromise of February 1987 described below,<sup>164</sup> but, according to the financial press, there was a private memorandum circulated among the major banks at the July 1986 City Bank Roundtable detailing reasons for a shift toward a neutral position.<sup>165</sup> Finance Ministry and Bank of Japan (BOJ) officials told us that bankers presented them with widely diverse views on the question.

There was also significant official support for creation of a commercial paper market; the BOJ began to champion this position and it issued an official report to that effect in January 1987.<sup>166</sup> The BOJ shift from neutrality toward active support was partially motivated by new CP markets in Europe. BOJ officials expressed the concern that if commercial paper was not introduced within the domestic Japanese financial markets, financial transactions would simply move overseas.<sup>167</sup>

<sup>161</sup> See, e.g., *Bankāzu no CP Gyōmu ni Gohō Hanketsu*, Kinyū Zaisei Jijō, Jan. 19, 1987, at 72-73 (reporting the decision in *Bankers Trust II*, discussed *supra* note 77 and accompanying text).

<sup>162</sup> See *CP wa Tegata Atsukai: Nichigin, Kokunai Dōnyū e Kenkai*, Nihon Keizai Shinbun, Jan. 21, 1987, at 11 [hereinafter *Nihon Keizai Shinbun*, Jan. 21, 1987] (claiming U.S. banks' stance to be the source of scattered Japanese bank support for commercial paper).

<sup>163</sup> Kinyū Zaisei Jijō, July 7, 1986, *supra* note 160, at 32.

<sup>164</sup> See *infra* text following note 166.

<sup>165</sup> See *Kokunai CP Shijō "Kokkakuzu" no Kōzaihaibo*, Kinyū Zaisei Jijō, May 4, 1987, at 38.

<sup>166</sup> See Kosugi & Dickinson, *The Creation of a Domestic Commercial Paper Market in Japan*, 27 COLUM. J. TRANSNAT'L L. 91, 109 (1988) (citing TANKI SHIJŌ, THE SHORT-TERM FINANCIAL MARKET 288 (Nihon Keizai Shimbunsha ed. 1987)).

<sup>167</sup> See *Nihon Keizai Shinbun*, Jan. 21, 1987, *supra* note 162, at 11. Officials at the

#### D. *The Ministry of Finance Decision*

Against the background of this private sector and official activity, the commercial paper question came under official scrutiny for the second time in 1986. With powerful forces favoring the creation of a commercial paper market and the bank opposition weakening, MOF officials were now more amenable to the idea than they had been in 1981. But they faced a practical problem in developing a procedure for deciding the issue. Under ordinary circumstances, administrative decision-making in Japan follows well-defined channels, with each ministry within the government and each bureau within each ministry having clearly defined areas of jurisdiction. It was respect for this clear division of jurisdiction that made MITI, the BOJ, and even the Diet reluctant to force the issue in the early 1980s when the MOF decided not to take action. The problem now lay within the Ministry. Two of its most important bureaus are the Banking Bureau and the Securities Bureau, and the commercial paper issue fell between them. Moreover, the fact that it fell between them was not simply an accident of administrative organization, to be resolved by a mixture of decisive action and feather smoothing; rather, it was the very essence of the conflict. To assign the task of creating a commercial paper market to the Banking or Securities Bureau would have effectively decided the question at issue: is commercial paper a banking function or a security?

The internal structure of the Japanese bureaucracy served to heighten the conflict. Japanese officials, who have the most prestigious educational credentials in the nation, are appointed to a ministry for their entire careers in government, and their professional success depends upon their effectiveness in their assigned positions. Although they are rotated from one bureau to another every two or three years to avoid developing ingrained attitudes, they devote their intelligence and energy, as well as sixty to eighty hours of work per week, to their position at the time, and

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BOJ suggested that their report, prepared in late 1986, had been leaked to the press. As an influential institution and one responsible in part for regulating the banking sector, BOJ's support for commercial paper could easily have had an impact on the banks' position. Further, the BOJ report was the first official, governmental support for commercial paper.

The major features of the BOJ proposal were that commercial paper be considered a note rather than a security, that credit rating agencies rate the commercial paper, and that back-up credit lines be required.

often measure their success by their ability to take charge of problems and develop new statutory or administrative solutions. In addition, each bureau has extensive contacts with members of the industry it regulates and tends to serve as an advocate for its interests, as well as a regulator of its activities.<sup>168</sup> Thus, a conflict between two major bureaus within the Ministry was not something that either insiders or outside interest groups would take lightly.

The MOF's solution, not surprisingly, was to have the chiefs of the two relevant Bureaus, Mr. Hirasawa of Banking and Mr. Kitayama of Securities, meet together in late 1986 or early 1987 to agree upon a decision-making procedure. The precise nature of this procedure, and the exact chronology of events, are lost within the misty confines of the MOF. Hirasawa and Kitayama did not sit in the same room and discuss the details of the proposal; they were too senior to do so and the potential for direct conflict would have been too great. Rather, they assigned the task to their immediate subordinates—for the Banking Bureau, Mr. Nakahira of the Banking (i.e. big banks) Section and, for the Securities Bureau, Mr. Uchida of the Capital Markets Section. Nakahira and Uchida, however, were also too senior to meet together. They assigned their assistants to deal with the issue and it was apparently at this level that the bureau-to-bureau contacts within the Ministry occurred.

These contacts proceeded during January and February of 1987 under the direction of Nakahira and Uchida, the two section chiefs. Our information suggests that Uchida was probably the guiding force. In hammering out a compromise, the officials consulted extensively with their industry contacts, generally on an *ex parte* basis. They were motivated by a desire to find a solution that was acceptable to both industries, so that the final decision would rest with the MOF, and neither side would appeal to the Diet for new legislation, as the securities industry had apparently done in 1981. In addition, they wanted to have an agreement on their records before June 1987, when many of them would be rotated to new positions. This was particularly important to the officials in the Banking Section, who had not undertaken any major initiatives during the previous years.

The negotiations proceeded quickly, and the MOF informally indicated that it had decided on a proposal in February 1987.<sup>169</sup>

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<sup>168</sup> See F. ROSENBLUTH, *supra* note 28, at 19-20 (discussing the prestige that attaches to a position in the Japanese bureaucracy).

<sup>169</sup> For accounts of the progress of the negotiations, see, e.g., *CP Rūru Sakusei*



This decision, as one might expect, represented a compromise between banking and securities interests.

First, as had been suggested in both the securities industry and Bank of Japan proposals, commercial paper would be introduced as a promissory note and not a security. This would enable the market to go forward immediately, without involvement of the Diet to create a new legal form. The promissory note approach allowed both banks and securities firms to participate in the market, an essential element to a successful compromise. It also allowed more favorable tax treatment for commercial paper than for securities under existing laws, as a graduated stamp tax would be levied instead of a securities transaction tax. The alternative—treatment as a type of corporate bond or debenture under Japanese law—was unacceptable. Bank participation would have been foreclosed, onerous disclosure requirements would have applied, and the Corporations Law<sup>170</sup> would have required board of directors approval before each issuance of commercial paper.

Second, “direct paper” (commercial paper sold directly from issuer to investor) would not be allowed. Only “dealer paper” (commercial paper underwritten by a bank or securities firm) would be accepted. This was described to us as allowing banks to maintain an advantage over non-bank competitors at raising funds, considered an important point by the MOF until the terms of bank competition with non-bank financial services companies are resolved. In fact, since non-bank finance companies were not permitted to issue commercial paper, this explanation seems inadequate. Prohibiting direct paper obviously favors the banks and securities firms, and may have been part of the effort to protect banks and alleviate bank opposition. It also is in the interests of the MOF, since the MOF has little regulatory authority over issuers, and could not easily control a market where issuers dealt directly with

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Özume, *Nihon Keizai Shinbun*, Apr. 7, 1987, at 5 (reporting that there would be 180 eligible issuers, and that back-up lines would probably be required for most issuers); *CP Hakkō kigyō 100-sha Zengo: Rūru Katamaru*, *Nihon Keizai Shinbun*, Mar. 19, 1987, at 3 (reporting that only dealer paper would be permitted, predicting that only 100 corporations would meet the requirements for issuance, and noting that the MOF planned to complete product design by June and open the market by the end of 1987).

<sup>170</sup> See SHŌHŌ, art. 296. For a discussion of this provision of Japanese corporate law, see Yoshikawa & Harada, *Kokunai CP Shijō Sōsetsu ni Tsuite*, *Kinyū Zaisei Jijō*, Nov. 23, 1987, at 34, 35.

investors. Only issuers and investors, under-represented in the MOF decision-making process, have reason to favor direct paper.

After the February agreement, the Banking and Securities Bureaus began to work together on the other elements of the commercial paper market. The major decisions were made over the next few months with further *ex parte* contacts between the MOF and the two leading industry groups. Other groups were not fully aware of the progress of events until the February announcement, and needed quickly to organize their position. The large trading companies, which have turned out to be the most active issuers of commercial paper, established a commercial paper working group, and by the end of March, had submitted a very liberal proposal to the MOF.<sup>171</sup>

Another element in the MOF's decision-making process was the meetings of the Commercial Paper Advisory Group. Virtually every bureau of every Japanese Ministry has a standing advisory council (*shingikai*) that meets to consider proposed changes in that bureau's regulatory activities. The precise role of these advisory councils is a matter of debate among people we interviewed; the advisory councils may be important sources of new ideas, or provide guidance and information for the officials who make the decisions, or help these officials obtain assent to decisions the officials alone have made, or serve a purely decorative function. Whatever their role, the MOF's standing advisory councils were of limited value in the commercial paper decision, since each related to a single bureau. These relations significantly constrained their advisory functions. The Securities Transactions Council of the Securities Bureau had issued a report in 1986 that vaguely proposed further study, but lacked a clear recommendation.<sup>172</sup> The Financial System Research Council of the Banking Bureau had not issued any report at all. Thus, when the joint Banking-Securities process was initiated, the MOF decided to create the Commercial Paper Advisory Group, an ad hoc council selected from those members of the two advisory councils who lacked any direct stake in the banking or securities industries. The members and their positions were as follows:<sup>173</sup>

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<sup>171</sup> See *Kokunai CP An wa Riyōsha no Shiten o Kaite Iru*, Kinyū Zaisei Jijō, May 25, 1987, at 35 (interview with official of Mitsui & Co.); *Shōsha ga Kokunai CP Hakkō ni Tsuite no Yōbōshō o Teishutsu*, Kinyū Zaisei Jijō, Apr. 20, 1987, at 9.

<sup>172</sup> See Shokentorihiki Shingikai, *Shasai Hakkō Shijō no Arikata ni Tsuite* (Dec. 12, 1986), reprinted in T. AMAYA, *supra* note 130, at 85-86.

<sup>173</sup> See T. AMAYA, *supra* note 130, at 89.

Ryuichiro Tachi	Professor Emeritus, Tokyo University Law Faculty (Chairperson)
Toshimichi Kajiki	Advisor, Kansai Electric Power Co., Ltd.
Michio Kondo	Chairperson, Hakuhodo (advertising agency)
Akio Takeuchi	Professor, Tokyo University Law Faculty
Takuhiko Tsuruta	Executive Vice President, Nihon Keizai Shinbun, Inc.
Tetsuro Nishizaki	President, International Management Consultants, Ltd.
Yo Maeda	Professor, Gakushuin University
Shinichi Royama	Professor, Osaka University
Mikio Wakatsuki	Director General, General Affairs Bureau, Bank of Japan

This ad hoc Advisory Group met only twice, once on April 23, 1987 and again on May 14.<sup>174</sup> At the second meeting, it approved the MOF proposal in its entirety. The limited number of meetings and the absence of proposed amendments or lengthy debate gave the ad hoc group the appearance of a rubber stamp. It is commonly said that in Japan formal debate (such as presentation to an advisory council) often follows most of the actual negotiation; this certainly appears to have been the case with the Advisory Group. Its role was apparently to add legitimacy to the MOF decision. Particularly in light of trading company complaints that the proposal favored the interests of banks and securities firms, it was important that a neutral group lacking banking or securities representatives approve the result. The appearance of neutrality was important for the MOF to maintain its ability to negotiate enforceable compromises, and to discourage the regulated industries from seeking help in the Diet or some other forum.

This explanation of the Advisory Group's role may be a bit too simple, however. The officials who negotiated the compromise among themselves knew they would need to obtain the assent of the industry groups. Moreover, the terms of the discussion in the Advisory Group may have served as an intellectual framework for the officials' analysis of the issue. There has been an ongoing debate among Japanese law professors about corporate finance, with the theoretical school maintaining that the law should place all corporate debt and equities in strict categories, and the pragmatic school maintaining that the law should follow business practices.<sup>175</sup> Professor Akio Takeuchi, of the University of Tokyo Law Faculty, was the leader of the pragmatic school, and many of the MOF officials, being graduates of that school, had studied under

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<sup>174</sup> See *Ōkurashō, CP Kondankai de Shohin Genan o Teiji*, Kinyū Zaisei Jijō, May 4, 1987, at 31.

<sup>175</sup> See Interview with Professor Takeuchi (June 28, 1988).

him. Takeuchi was a member of the Advisory Group, and the discussion in the Advisory Group focused on the merits of the pragmatic approach. These discussions, therefore, may have reflected the discussions among MOF officials rather more than the temporal order of the two would suggest.

Six days after the Commercial Paper Advisory Group approved the MOF proposal, the standing advisory councils of the Banking and Securities Bureaus also approved the proposal. The details of issuing, transferring and redeeming commercial paper were worked out between May and October, and uniform dealer contracts and commercial paper certificates were developed. On November 2, 1987, the two Bureaus issued nearly identical notifications to their respective industries, explaining the MOF's requirements for issuing, underwriting, and trading commercial paper.<sup>176</sup> These notifications provide the only basis for the commercial paper market. They are not based on any explicit statutory directive, and have no binding legal effect.<sup>177</sup>

No one was wildly enthusiastic about the final result. Potential issuers of commercial paper were disappointed by the MOF's various restrictions, including a minimum one month maturity date and a restriction on the number of issuers, as well as the prohibition on direct paper already discussed. They saw these restrictions as efforts to keep the commercial paper market from replacing too much of the banks' short term lending business, just as they saw the prohibition on direct paper as an effort to include banks in whatever commercial paper market did develop. They also objected to the Ministry's graduated stamp tax, amounting to 0.24% of the face value for a one billion yen issue with a one month maturity rolled over for one year.<sup>178</sup> They noted that this tax put commercial paper at a disadvantage vis-à-vis bank lending, to which no such tax applies. No stamp tax, minimum maturity, issuer restriction, or

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<sup>176</sup> See Ministry of Finance, Banking Bureau, Notification No. 2825, Nov. 2, 1987, *trans. in* Kosugi & Dickinson, *supra* note 166, at 133-34; Ministry of Finance, Securities Bureau, Notification No. 1830, Nov. 2, 1987, *reprinted in* Kinyū Zaisei Jijō, Nov. 9, 1987, at 72-73 and Kinyū Hōmu Jijō, Nov. 25, 1987, at 37-38 (also reprinting various other documents of interest to market participants).

<sup>177</sup> The MOF has ample discretionary powers over the banking and securities industries to enforce such compromises. It does not, however, have such powers over non-financial corporations. As Kosugi and Dickinson remark, this lack of MOF control over issuers is one reason that direct paper is prohibited. See Kosugi & Dickinson, *supra* note 166, at 115.

<sup>178</sup> See *id.* at 113.

back-up line requirements exist in the U.S. commercial paper market.

Securities firms also expressed dissatisfaction with the MOF proposal. They felt that bank participation had been accepted for purely political reasons, without any discussion of the policies behind article 65, or the potential for conflicts if the same bank underwrites commercial paper, provides the back-up line, and ends up holding unsalable paper.<sup>179</sup> Securities firms also worried that the bank monopoly on back-up lines and payment agency business would allow banks to gain advantage in the marketplace.

Meanwhile, the banks had lost out in their effort to prevent a commercial paper market from being established. Their proposal that the market be limited to fewer than one hundred corporations had also been rejected, and instead nearly twice that number would be eligible to participate from the beginning. Banks felt that short-term finance was properly their monopoly, and saw commercial paper as an invasion of their turf by the securities industry.

MOF officials considered this result—some dissatisfaction on all sides, but with all parties willing to acquiesce in the proposal—the best that could realistically be expected. In fact, all parties we met with saw this dissatisfaction as evidence that a fair compromise had been reached.

One additional detail of the MOF proposal also helped to alleviate the mild dissatisfaction all parties felt. The proposal stated that the structure of the commercial paper market would be reviewed after one year of operation. Those who felt the market was too restrictive realized that, as in other newly liberalized areas of Japanese finance, the review would probably result in a relaxation of requirements. On the other hand, the banks knew that if commercial paper caused serious trouble for short-term bank lending or bank profitability, they would have an opportunity to present their case to the MOF.

#### E. *The Commercial Paper Market In Practice*

The Japanese domestic commercial paper market opened on November 20, 1987, exactly six months after approval of the MOF's proposal by the two standing advisory councils.<sup>180</sup> On its first day

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<sup>179</sup> See *Ginkō ni Yoru Kokunai CP no Jikohoyō ni Mondai wa Nai ka*, Kinyū Zaisei Jijō, July 27, 1987, at 17.

<sup>180</sup> See Yoshikawa & Harada, *supra* note 170, at 35.

of operation 800 billion yen (\$6 billion) of commercial paper was issued.<sup>181</sup> The market grew at a steady pace with the amount of commercial paper outstanding reaching 4 trillion yen (\$30 billion) by the end of April 1988. By the end of August 1988, it had reached 5.641 trillion yen (\$42 billion), surpassing the bill discount market in size,<sup>182</sup> and following the one-year review's relaxation of requirements, it grew to over 10 trillion yen (\$75 billion).<sup>183</sup>

Banks and securities firms were initially willing to underwrite commercial paper at unsustainably low rates, well below the margins required for profitable dealing. Although rates increased gradually throughout 1988, approaching the rate for CDs, commercial paper distribution remained unprofitable. Underwriters purchased and distributed commercial paper only as a way to ensure a share of the issuer's other business, deeming commercial paper "charity paper" or "connection paper."<sup>184</sup> Participants reported to us that issuers engaged extensively in arbitrage: they would issue commercial paper and then place the funds obtained from the issues into higher yield bank time deposit accounts or Cds. Such arbitrage was estimated to account for the lion's share of commercial paper, up to eighty or ninety percent, at least until the interest rates paid by commercial paper issuers began to increase in the summer of 1988.<sup>185</sup> The largest purchasers of commercial paper were investment trusts, followed by the smaller regional and mutual banks, which found that commercial paper gave a higher yield on their funds than the call market.<sup>186</sup>

<sup>181</sup> See *id.*

<sup>182</sup> See *Rēto Jōshō de Kugatsumatsu wa Genshō*, Nikkei Kinyū Shinbun (The Nikkei Financial Daily), Sept. 19, 1988, at 1.

<sup>183</sup> See *CP-ope Raishū ni mo Jisshi*, Nihon Keizai Shinbun, May 16, 1989, at 1.

<sup>184</sup> See *Japan Commercial-Paper Market Grows Although Critics of System Abound*, Wall St. J., Oct. 31, 1988, at C23, col 1.

<sup>185</sup> This was revealed through conversations with securities and banking industry participants in June 1988. The arbitrage was widely reported in the financial press. See, e.g., Nikkei Kinyū Shinbun, May 3, 1988, at 1 (noting that issuers were taking advantage of "blood letting" rates and placed proceeds of issuance in large-scale time deposit accounts); see Nikkei Kinyū Shinbun, June 29, 1988 (reporting that the gap narrowed between commercial paper rates and the effective interest rate on bank borrowings, and predicting an end to arbitrage issuance). Although margins have narrowed, arbitrage issuance continued to dominate the market into 1990. The amount of funds in large-scale time deposits at any time is closely correlated with the amount of commercial paper outstanding, evidencing this widespread arbitrage.

<sup>186</sup> See *Kokunai CP Shijō ni Kekkan, Da ga Ni-Chō En ni*, Nihon Kinyū Shinbun, Feb. 19, 1988.

The market in commercial paper sold under repurchase agreements (*gensaki* commercial paper) grew even faster than the underlying commercial paper market, and proved a welcome supplement to the existing *gensaki* market in government bonds. For the month of August 1988, total *gensaki* commercial paper transactions totalled over 50 trillion yen (\$375 billion).<sup>187</sup>

During the first few months of operation, banks and securities firms underwrote commercial paper in relatively equal shares. As time progressed, however, the banks' share of commercial paper underwriting business increased to around seventy percent, leaving securities firms the remaining thirty percent.<sup>188</sup> In September 1988, the Bank of Japan announced that it would begin open market operations in commercial paper to increase its control over short-term financial markets and interest rates.<sup>189</sup>

The commercial paper market appeared to be a success with its growth exceeding most expectations. MOF officials expressed general satisfaction with the development of the market and no awareness of any great problems. The banks were pleased that commercial paper had not cut into their basic businesses as much as might have been feared, and that they had won a large share of the commercial paper market. The securities firms, however, were less happy with the development of the market. They claimed that the banks' large market share was based not on the merits of competition, but on regulatory advantages. Market observers and participants expressed concern with the widespread existence of arbitrage and the apparent failure of corporations to use the market to meet their actual needs for short-term funds. The heavy stamp tax, along with the small number of eligible issuers, limited the commercial paper market's potential.<sup>190</sup> Further, the market was closed to finance companies and securities firms, the non-bank commercial paper issuers who dominate the market in the United States.<sup>191</sup>

<sup>187</sup> See *CP Ryūtsū Shijō ga Kyūkakudai*, Nihon Keizai Shinbun, Sept. 17, 1988, at 7.

<sup>188</sup> This statistic was provided by MOF officials, and confirmed by market participants.

<sup>189</sup> See *Japanese Money Markets: Coming Home*, *ECONOMIST*, Nov. 19, 1988, at 93 [hereinafter *Japanese Money Markets*]; *Ōpun Shijō Arata na Chōsetsu Shudan*, Nihon Keizai Shinbun, Sept. 15, 1988, at 11.

<sup>190</sup> See Wall St. J., Oct. 31, 1988, at C23, col. 1.

<sup>191</sup> For a general discussion, see *Guidelines for Domestic CP and Its Revision*, ZENGINKYO FIN. REV. No. 4 (1989).

As promised in the MOF commercial paper proposal, the market was reviewed in November 1988, after one year of operation, and, as before, the decision-making process was confined to the MOF, and involved extensive discussions with industry representatives. The securities firms and trading companies took similar aggressive positions in favor of market liberalization. The securities firms proposed that the requirements for qualification as an issuer be relaxed, with the implementation of a rating system for commercial paper, and any commercial paper issue allowed that received one of the two highest ratings. Issues would not be limited to corporations listed on the Tokyo Stock Exchange, but would be permitted for other corporations which provide continuing disclosure. A subsidiary corporation not meeting the requirements for issue would be allowed to issue based upon a guarantee by its parent corporation or a financial institution. Most importantly, securities firms and finance companies would be allowed to issue commercial paper.<sup>192</sup> The trading companies' proposal, presented through a trade association, differed little.<sup>193</sup>

Under both proposals, the stamp tax would be fixed at 200 yen per certificate, as with yen-based bankers' acceptances, the minimum maturity of one month would be dropped, and the maximum maturity would be expanded from six months to one year. Back-up lines would be optional for all commercial paper issues receiving the highest rating. The minimum denomination would decrease along with that of the CD, recently relaxed from 100 million to 30 million yen.

The banks opposed nearly all the suggested changes. They took a passive or neutral position on implementing a rating system. They found no need to increase the number of eligible issuers, as this would reduce bank lending; and they found no need to expand the scope of permitted maturities, as the greatest issuer demand appeared to be for three month paper.<sup>194</sup>

The banks' strongest opposition was focused on proposed changes in the basic structure of the market. If securities firms and non-bank finance companies were allowed to issue commercial

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<sup>192</sup> This was revealed through discussions with Nomura Securities personnel, June 1988, and review of their preliminary draft of proposal for the one-year review. See (*Shokenkai Kara no*) CP no Minaoshi ni Tsuite no Yōbōjiko (An), May 1988 (Securities Industry Draft Proposal for One-Year Review of the CP Market).

<sup>193</sup> See *Nonbanku CP ni Hantai*, Nikkei Kinyū Shinbun, Sep. 29, 1988, at 1.

<sup>194</sup> See *id.*



paper, that commercial paper would resemble and compete with the banks' negotiable CDs. The banks argued that issues based on the guarantee of a parent company should be prevented in order to maintain confidence in a stable, orderly financial system. Issue of direct as well as dealer paper would be "premature," from the standpoint of market confidence and investor protection.<sup>195</sup>

The result of the one-year review was announced in November 1988. The MOF sided largely with the banks on the most fundamental issues, and reserved for further study proposals for any changes in the basic structure of the market. On proposals for expanding the scale of the market, the MOF compromised. A rating system was introduced, and standards for issuance were relaxed so that approximately 450 corporations would qualify. The number of issuers without mandatory back-up lines was likewise increased, and the MOF stated plans to limit back-up lines to some portion of issued commercial paper. The minimum maturity was shortened from one month to two weeks, and the maximum was lengthened from six to nine months. Otherwise, the market was to continue in operation as before.<sup>196</sup> These changes accompanied the Bank of Japan's liberalization of the short-term interbank money markets, including BOJ trading in commercial paper.<sup>197</sup> The BOJ began trading commercial paper, shortened maturities in the bill discount market from one month, and announced plans to trade one-week and three-week bills for its own open market operations. The longest maturity of the call market was expanded from three weeks to six months.<sup>198</sup>

The gradual approach that MOF adopted toward regulatory change held three advantages from the Ministry's perspective. First, it eased the impact of the changes on the affected institutions, thereby allowing them to adjust. This was a benefit in itself and also made it easier to pursue regulatory change in the future. The result

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<sup>195</sup> See *id.*

<sup>196</sup> See *Yen Commercial-Paper Market: Chinked Armour*, *ECONOMIST*, Dec. 10, 1988, at 91-92. A second review of the CP market was completed on February 15, 1990. The number of eligible issuers again increased, to 530 firms. More importantly, beginning in October of 1990, no bank back-up line will be required if acceptable to a rating agency. Also, a tax law revision effective April 1, 1990, drastically reduced the stamp tax burden on CP. The tax on a 100 million yen CP certificate decreased from ¥40,000 to ¥5,000. See *CP Shijō no Genjō Rūru Minaoshi ni Tsuite*, *Kōshasai Geppō*, Feb. 4, 1990, at 15-27; *Kokunai CP Saiminaoshi no Inpakuto*, *Kinyū Zaisei Jijō*, Feb. 2, 1990, at 16-23.

<sup>197</sup> See *Japanese Money Markets*, *supra* note 189, at 93.

<sup>198</sup> See *id.*

of this lessening was that the ferocity of opposition from the beneficiaries of regulation was reduced. As a general matter, the institutions that rely on protected market niches may grudgingly accept gradual change although they would fight desperately to avoid the overnight destruction of their niche.

Second, the gradual approach also gave the MOF time to assess the impact of a regulatory change on the financial system. This in turn permitted the MOF to achieve its prime regulatory goal of maintaining the stability of the financial system. A gradual approach by regulators eases worries of financial chaos and collapse when major changes, such as the deregulation of interest rates, introduction of unsecured corporate bonds, or establishment of a commercial paper market, take place.

Finally, the gradual approach resulted in a steady stream of MOF decisions, and thus made regulatory policy-making an ongoing process. This added to the MOF's power over the regulated industries and made resort to the Diet as protection from the MOF less practical. Even if an interest group could persuade the Diet to make a satisfactory initial decision, the MOF could later change the details. For the regulated industries, maintenance of a good relationship with the MOF remained the preferred approach.<sup>199</sup>

#### IV. ANALYSIS

Having described the events in Japan and the United States, we turn now to a comparison of the two case histories and, in particular, to the process of administrative decision-making in these two large, highly industrialized nations. The comparison is facilitated by the similarity between the two nations, not only in the statutory scheme, but also in the underlying market forces.

In both nations, commercial paper represented a threat to the core bank business of providing short term credit to large business enterprises. To be sure, in Japan the commercial banks so dominated the short-term credit business that there was no commercial paper market at all prior to 1987,<sup>200</sup> whereas in the United States

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<sup>199</sup> The gradual approach contrasts with London's "Big Bang" of October 1986, when, following a major legislative revision, British regulatory authorities deregulated and reorganized the London securities markets in one massive event. *See, e.g.,* Marshall, *The Big Bang Rocks London*, L.A. Times, Oct. 27, 1986, §4, at 1, col. 2 (noting, "collectively, the changes [associated with the Big Bang] are the most sweeping ever undertaken by any major financial center").

<sup>200</sup> *See supra* text accompanying notes 126-30.

a commercial paper market had always existed, although its dimensions were relatively modest until fairly recently.<sup>201</sup> This meant that in Japan banks were in the position of guarding a rent as to which they had a near-monopoly, whereas in the United States banks were attempting to recover a rent which had been partially appropriated by the securities industry. Thus, in Japan, banks were in the conservative posture of resisting change, while in the United States they assumed the role of agitators for reform. These different roles, however, should not obscure the underlying reality that in both countries banks were resisting inroads into their core businesses of providing short-term business credit.

In both countries the fight over commercial paper was merely one part—although a central part—of a broader set of dynamic developments in politics and financial markets. Advances in information and communications technology meant that sophisticated institutional investors could evaluate the creditworthiness of major industrial corporations without the need to rely on the expertise of a commercial bank or other financial intermediary. These technological and market developments greatly increased the degree to which commercial paper could displace commercial bank loans as a source of short term credit to industry. More generally, as the efficiency of direct investments increased, banks became interested in entering the securities business in a variety of ways, of which commercial paper was only the most important initial product.<sup>202</sup>

In both countries the commercial paper decision was influenced by the globalization of financial markets. In the case of Japan, the decision to establish a commercial paper market was partly a response to pressure from the United States and other western governments. These governments believed that the lack of short term credit markets in Japan impeded the growth of the yen as a truly international currency. The Japanese were also acutely aware of developments in the American and European commercial paper markets.<sup>203</sup> Events in the United States were not influenced by these sorts of international considerations; nevertheless, the argument for American bank entry into the securities business was greatly strengthened by the fact that the largest American banks were already underwriting securities in overseas markets to which

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<sup>201</sup> See *supra* notes 13-24 and accompanying text.

<sup>202</sup> See *supra* notes 10 & 14-27 and accompanying text.

<sup>203</sup> See *supra* notes 143-48 & 161 and accompanying text.

the provisions of the Glass-Steagall Act do not extend. It was also significant that American banks were competing in a global marketplace which included powerful European banks with broad securities underwriting powers. Thus, although the globalization of world financial markets affected the United States and Japan differently, the general fact remains that events in both countries were deeply influenced by developments in world financial markets.

Given these similarities of underlying market forces and economic consequences, we can trace the similarities and differences in the American and Japanese decision-making process. At the outset, any hypothesis about a higher level of consensus in Japanese society must be rejected. In both countries, consideration of the issue was accompanied by intense interest group lobbying, with the big banks squaring off against the big securities firms. Although the conflict was more public in the United States, it was no less intense in Japan, notwithstanding the fact that it was played out in a private rather than public arena. Measuring the strength of interest group pressures is difficult, but the ferocity of the conflict in Japan was remarkable and may actually have exceeded the intensity of the American struggle.

#### A. *The Preclearance-Postclearance Distinction*

While the level of conflict was equally great, the means by which the conflict was expressed and resolved in America and Japan were distinctly different. We believe that the most important underlying difference between the two histories can be captured in the distinction between what we call "preclearance" and "postclearance" methods of conflict resolution. The event of "clearance" may be identified as a generally-announced decision by the decision-maker who is officially assigned to resolve the issue. Within a corporation, this decision-maker might be the officer assigned to a particular area of operations, and the general announcement might be a business report to the CEO. In the government, the decision-maker will often be the administrative agency that has primary jurisdiction of the area, and the announcement will be the first official decision.

As is apparent, clearance is a relative concept. If one identifies the firm in its entirety as the decision-maker, rather than one of its officers, and its first statement to the public or to the government as the announcement, rather than a report to that officer, the amount of conflict resolved at the preclearance and postclearance stages will be different. Similarly, one might regard subdivisions of

the responsible administrative agency as the decision-makers, and statements to the agency head as the announcement; this again would affect the distribution of events between the stages. The reason is that clearance, as we use the term, is not a real-world event. It is not a concept consciously available to the actors. Rather, it is an interpretation, a means of understanding patterns of decision-making and comparing them to one another. Its value, therefore, is not derived from the precision with which it can be located, but rather from its usefulness for understanding the process in question.

One useful hypothesis that might be derived from the concept of clearance, when it is applied to a given institution, is that the level of preclearance conflict resolution increases as the event of clearance is set higher in the institution's hierarchy. For example, in a corporation, more conflicts will be resolved before a statement is made to the public by the corporation's CEO than are resolved before a statement is made to the CEO by the chiefs of corporate sub-units. If empirical data indicate that this hypothesis is valid, it would suggest that the concept of clearance is a useful one for understanding institutional decision-making.

We believe that the concept of clearance is useful for making cross-cultural comparisons between analogous decisions. Specifically, it is our hypothesis that when the event of clearance is set at equivalent levels of government, Japanese government officials resolve more conflicts at the preclearance stage than American officials. The question of equivalence is a complex one, of course, often beset by all the difficulties of cross-cultural comparison. In our case study, however, the answer to this question is facilitated by the similarity of the issue in both nations, and the consequent ease in identifying equivalent government decision-makers.

The U.S. government decision-maker that was initially assigned to resolve the commercial paper issue was the Federal Reserve Board. The Board's jurisdiction derives from direct statutory authorization. In Japan, the decision-maker was the Ministry of Finance, which possesses comprehensive jurisdiction over all activities by financial institutions. Clearance occurred when each agency announced its interpretation of the governing statute regarding the ability of commercial banks to deal in commercial paper.

Interestingly, the decisions that constituted clearance in each case were essentially equivalent. In 1980, the Fed declared that commercial paper was not a security for purposes of the Glass-

Steagall Act and that banks could therefore buy and sell it for their own account. Because of the potential hazards, however, the Board imposed a number of restrictions aimed at insuring that the paper was high quality, and that it was sold to sophisticated investors, not to the general public.<sup>204</sup> The MOF's decision, announced in May 1987, and officially promulgated in November of that year, was also that commercial paper was not a security, and that banks could therefore participate in the newly-created market. The MOF also imposed restrictions, the principal ones being limited issuer eligibility and mandatory bank back-up lines to ensure the quality of commercial paper issues.<sup>205</sup>

In both cases, therefore, the agency adopted a similar approach, ostensibly as its best interpretation of the statute, but also as a way of going forward with deregulation, while avoiding statutory language that could only be changed by legislative action.<sup>206</sup> Moreover, restrictions were imposed in both cases that were ostensibly designed to decrease risk, but also intended to satisfy conflicting interest groups, while retaining the agency's control over the market.<sup>207</sup>

There was, however, a dramatic difference between the two decisions, despite their substantive similarity. The Federal Reserve decision was simply the first stage in an extended decision-making process that involved two levels of judicial authorities, a subsequent decision by the Fed, and a variety of subsidiary actors and events. The MOF's decision, however, was final; once it was announced, all the Japanese participants agreed that there was nothing further to be done at the time. There was a one-year review, but this was planned by the MOF, and followed the Ministry's format.

This account describes the external appearance of events and also reflects the views of those who participated. The Federal Reserve made the decision that constituted clearance on the basis of a complaint filed by a trade association representing the opposing side. As soon as it undertook the decision-making process, it knew that it would be sued by the loser; as soon as it issued the decision, it knew the plaintiff would be the SIA, and that its decision favoring Bankers Trust would be reviewed in federal court. It also knew that the loser of the federal court battle would

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<sup>204</sup> See *supra* note 48 and accompanying text.

<sup>205</sup> See *supra* notes 176-78 and accompanying text.

<sup>206</sup> See *supra* notes 45-46 & 168-71 and accompanying text.

<sup>207</sup> See *supra* notes 48 & 168-71 and accompanying text.

appeal to Congress. Undoubtedly, the Fed hoped it would prevail in both these forums, but it knew that it had not finally resolved the conflict at the preclearance level, and that there would be a great deal of decision-making activity following its action.

The MOF, in contrast, worked hard to resolve the conflict before it issued the decision that constituted clearance. It vigorously utilized an extensive network of contacts, at both the formal and informal level, with both sides in the dispute, and used both existing and specially created study groups to persuade the opposing groups to accept the solution it devised. Once the MOF acted, it expected its decision to be final. Those with whom we spoke agreed that it would be virtually inconceivable for any of the industry groups to bring legal action against the MOF. An appeal to the Diet might have been conceivable, but, for reasons discussed above, it would be unlikely to succeed and might well backfire.<sup>208</sup>

The fact that the conflict between opposing forces was principally resolved at the preclearance level in Japan does not mean that Japanese authorities were necessarily more effective in resolving the entire conflict than authorities in the United States. The American process reveals a range of postclearance conflict resolution mechanisms that were not present in Japan, most notably litigation and judicial decisions. It is a mistake to see the resort to litigation as a breakdown in the decision-making process; rather, it was an integral part of that process. The various participants, both private and governmental, were able to argue their positions in the courts and the judges added their views in developing the ultimate resolution.

If litigation was not a breakdown in the American decision-making process, neither was it the endpoint of that process. The final resolution (here, as in Japan, subject to reconsideration in light of subsequent events) was announced by the Federal Reserve, and approved by the courts. In other words, litigation may be viewed as one step in the decision-making process, one that is not qualitatively different from other steps, but is rather a natural part of a post-clearance conflict resolution. The courts themselves perceived their decisions in this light. When the Supreme Court reversed the Federal Reserve Board's first decision, and declared commercial paper to be a security,<sup>209</sup> it added the broad hint that it was not

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<sup>208</sup> See *supra* notes 133-37 & 199 and accompanying text.

<sup>209</sup> See *Bankers Trust I*, 468 U.S. 137, 140 (1984).

deciding that Bankers Trust's commercial paper operations constituted underwriting.<sup>210</sup> It thereby invited the Board to issue a new decision on this point, a decision which could—and did—produce an opposite result from its own.<sup>211</sup> Similarly, when the Second Circuit approved this later Board decision, it recognized that this decision could be altered or reversed by congressional action.<sup>212</sup>

While litigation and legislation should thus be regarded as conflict resolution mechanisms, like the various study groups and planning efforts that the Japanese employed, their use points to some basic differences between the preclearance and postclearance approaches. Postclearance decision-making is segmented into a series of distinct stages, with formal boundaries between them and a decision of some sort being announced at each stage. Preclearance decision-making, in contrast, is agglutinated into a continuous process of compromise and reconsideration, without boundaries or tentative decisions.

These relationships follow naturally from the character of clearance as the distinguishing event. Once clearance has occurred, and the initially responsible decision-maker has issued its announcement, the focus of decision-making must move to some other entity, generally one with juridical power to reverse the original one. If the process is to be coherent, that power cannot be invoked until the initial decision is announced; that is the reason that American appellate courts will generally deny jurisdiction until a "final" agency decision is made.<sup>213</sup> In contrast, if the conflict resolution process occurs at the preclearance stage, the interactions between participants must remain fluid and informal. Otherwise, the decision-maker's position will become apparent, and it will be unable to organize a compromise that is acceptable to the participants.

<sup>210</sup> See *id.* at 160 n.12.

<sup>211</sup> See *Bankers Trust II*, 807 F.2d 1052, 1055 (D.C. Cir. 1986) (describing the Federal Reserve Board's unpublished opinion), *cert. denied*, 483 U.S. 1005 (1987).

<sup>212</sup> See *Bankers Trust III*, 839 F.2d 47, 52 (2d Cir. 1988), *cert. denied*, 486 U.S. 1059 (1988).

<sup>213</sup> See, e.g., *Abbott Laboratories v. Gardner*, 387 U.S. 136, 148-51 (1967) (discussing interpretation of "finality" for purposes of jurisdictional question); see also Administrative Procedure Act, 5 U.S.C. § 704 (1988) (providing that "[a] preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review of the final agency action").



In essence, preclearance decision mechanisms are inherently fluid and informal, while postclearance mechanisms are inherently formal and segmented. Thus, to the extent that a particular society opts for preclearance mechanisms, it will tend to adopt informal strategies as well. Similarly, if a society opts for postclearance decision procedures it is also likely to choose formal strategies. Conversely, as a society adopts formal or informal strategies, it will tend to adopt postclearance or preclearance mechanisms. It is the linkage that is being asserted, not the direction of causality. In fact, the relationship that forges this linkage is almost certainly a co-causal one.

Litigation, the source of Derek Bok's recriminations against American society,<sup>214</sup> is clearly a central and intrinsic element in a postclearance strategy of conflict resolution. However, to ascribe the choice between preclearance and postclearance strategies to a preference for litigation is too simple. That choice relates, rather, to the ideals and the conceptual patterns of the relevant actors. For Japanese decision-makers, the ideal seems to be rational planning and consensus building. Open conflict is anathema to them; they would regard a public challenge to their announced decision as either an insult or a disgrace. Preclearance conflict resolution satisfies this ideal, because it seems to follow an orderly, administrative planning process which suppresses open conflict. In contrast, the ideals of American decision-makers are openness, fairness, and adherence to principle. They choose to make their decision and then defend it in a public arena. To be challenged or sued by a trade association like the SIA is a sign of independence, not disgrace. The informal preclearance decision-making that the Japanese employ would smack of backroom deals and supine corruption in the American context.

This does not mean that Americans are willing to relinquish any claim to consensus and rational planning, or the Japanese are willing to concede that they are unfair or corrupt. But choices between decision-making models must be made, and each choice naturally shades toward a particular ideal. The need to make a choice which actuates one ideal, when combined with the desire to retain the other, causes each model to incorporate some elements of the other, sometimes consistently, sometimes not. For example, while the Japanese process did occur largely within the confines of

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<sup>214</sup> See Bok, *supra* note 8, at 575-76.

the MOF, its deliberations were hardly a closely guarded secret. To the contrary, all parties to the dispute were well-informed throughout the MOF's deliberations, and the essential facts were widely reported in leading financial journals.<sup>215</sup> The widespread sharing of information among participants in a preclearance decision process is, indeed, essential to the effective function of that process with respect to decisions of any complexity, which will ordinarily be made through a series of subsidiary decisions. The process of vetting and consultation would not work effectively unless all parties knew which matters have been decided already, which have been excluded as not currently at issue, and which matters are presently under active consideration. The point is not so much that the dispute in Japan was resolved through a process that was secret as that the mechanism for resolving the dispute was private—it involved informal proceedings and extensive vetting of positions in advance and in place of public confrontation.

Nor was the American experience wholly a confrontational, public, litigation-driven phenomenon. There was a close working relationship between the Federal Reserve Board and Bankers Trust throughout the process; although the Board undoubtedly refrained from inappropriate *ex parte* contacts with Bankers Trust while cases were pending before it, there was nothing to stop private consultations between the bank and the agency prior to the initiation of contested proceedings.<sup>216</sup> The same cannot be said, however, for the big U.S. securities firms, which did not have the same sort of privileged access to the Board and which adopted an essentially confrontational and hostile position towards the Board throughout the proceedings. These firms would have enjoyed better access to the Securities and Exchange Commission, but that agency had little power to influence the outcome of the Board's deliberations—unlike the Securities Bureau of the MOF, which was able to influence the outcome in Japan by virtue of being a division of the agency charged with making the decision.<sup>217</sup>

Thus informal contacts were important in the United States, and, conversely, the Japanese controversy was not wholly devoid of the type of public, confrontational, formalized process which we have associated with a postclearance approach to dispute resolution. These convergences between models are natural ways of satisfying

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<sup>215</sup> See *supra* notes 155-69 and accompanying text.

<sup>216</sup> See *supra* notes 43-44 and accompanying text.

<sup>217</sup> See *supra* text accompanying notes 167-70.

conflicting ideals, but they do not alter the predominant pre-clearance and postclearance character of the two models as a means of explaining the different characteristics of the dispute-resolution process we observed in the two settings.

### B. *Comparing Preclearance and Postclearance Approaches*

Having characterized the decision-making process in Japan and the United States, the question that presents itself is how those two processes should be assessed. This is a question of both practical and theoretical significance. From the practical perspective, policymakers in both nations undoubtedly want to improve their government decision-making mechanisms. In addition, the two nations compete for worldwide markets, and the quality of their decision-making will affect their relative success in this arena. From the theoretical perspective, the quality of government decision-making in both countries should tell us a great deal about the effectiveness of their social organizations, and about institutional behavior in general. Since controlled experiments in governance strategies are generally impossible, an investigation of the different approaches adopted by two nations that possess a roughly equal material culture, and confront similar economic problems, represents the closest possible approach to such an experimental situation.

Assessments of this sort are, however, extremely complex. While superficial conclusions such as Derek Bok's broadside against litigation in America may attract attention and contribute to our current orgy of social self-flagellation, they provide no criteria for a real assessment.<sup>218</sup> If we try to take a more focused approach, however, we are confronted with the difficulty that the criteria to be applied are themselves the product of decision-making styles. Thus, in Japan, excellence in government decision-making is measured by the institution's ability to achieve consensus and develop a rational plan. In the United States, an excellent process is regarded as one that is fair, open, and principled. The criteria for excellence, not surprisingly, correspond closely with the ideals which guide the decision-makers and structure their institutions. In order to make a relative assessment of the two approaches, we need transcendent criteria, that is, criteria that exist apart from the ideals of particular

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<sup>218</sup> See *supra* note 8.

societies. For all practical purposes, however, there are no such criteria.

Lacking any ready means for making a global assessment, the best that can be done is to look at specific qualities, or virtues, of a governmental decision-making process. While we cannot determine the relative importance of each virtue, we can at least trace the extent to which each one is fulfilled. The virtues that we will discuss are the coherence of the process, its responsiveness to circumstances, its efficiency, its political accountability, and its fairness.

The coherence of the decision-making process might initially seem greater in Japan, particularly since it resembles the ideal of rational planning to which Japanese decision-makers aspire. Surprisingly, however, events in the two countries reveal substantially similar results in this area. The Japanese process was orderly and rational; at each step all participants were in general agreement about what had already been decided and was no longer open to question, what was currently on the agenda for decision in the short term, and what had been deferred for later action. The Japanese we interviewed showed exquisite sensitivity to these matters and displayed remarkable unanimity as to the current status of particular questions.

Surprisingly, however, the American process also turned out to evidence a fairly orderly and well-understood decision process. The Federal Reserve Board controlled the agenda of cases that came before it in order to move the process forward in a gradual fashion—deciding first the issue of bank commercial paper and a few other low-risk debt instruments, then corporate bonds, and finally corporate equities. In the same fashion as the MOF, the Board proceeded with great deliberation to allow the market to develop only under tight prudential limitations, which the Board, like the MOF, indicated could be loosened over time if the initial experiment with bank commercial paper activities proved successful. The Board was thus able to achieve a policy objective through a well-defined process of gradual deregulation.

It may seem as if postclearance events, particularly the litigation and the court decisions, disrupted the Fed's decision-making process to an extent that did not occur in Japan. But the Fed managed to move forward despite the Supreme Court's reversal of its initial decision that commercial paper was not a security. One might conclude that the Fed was able to recoup its position by using a different set of interpretive arguments. A stronger thesis, which

might well be justified, is that the Fed managed to incorporate the Supreme Court decision into its own decision-making process. It experimented with the solution of excluding commercial paper from the category of securities. Having been informed by the Supreme Court that this solution would not work—much as the MOF might have been informed by the law professors in its study group—it then pursued another approach. The Supreme Court certainly contemplated such a course of events, and its invalidation of the Fed's first resolution does not seem to have diverted the agency from its basic plan.

Conversely, the Japanese process, despite its well-planned appearance, reveals a heavy imprint of interest-group involvement. Powerful private organizations such as *Keidanren* (the Federation of Economic Organizations), the Securities Industry Association, and the City Bank Roundtable were in regular contact with MOF decision-makers. While these decision-makers undoubtedly thought that they were acting for the nation's benefit, they also knew that they had to satisfy these groups, and their decision-making process revealed several significant changes in direction as a result. For example, the entire planning process seems to have been initiated in response to pressure from *Keidanren* and the Securities Industry Association. Furthermore, the decision to allow only dealer paper backed by banks was clearly an effort to de-fuse bank opposition. While the process appears more orderly because these pressures and counterpressures were played out at the preclearance stage, the difference between the Japanese process and the American process may be precisely one of appearance. It may, in fact, reflect Japan's greater devotion to an ideal of rationality, rather than any significant difference in the level of rationality itself.

Apart from the orderliness and rationality of the decision-making process, another virtue of that process is its responsiveness to outside circumstances. Here, the American version seems superior. Because it was segmented, with a relatively smaller proportion of the total process occurring at the preclearance stage, it was easier to initiate. One firm, Bankers Trust, was able to attract the regulator's attention by sticking out its corporate neck, and the subsequent objection by a trade association quickly produced the first decision, the event of clearance in our terminology. The postclearance events that led to the final decision followed in fairly rapid succession.

In Japan, there was much more regulatory inertia. The MOF, perceiving commercial paper as an unwelcome intrusion into the

orderliness of its administrative dominions, remained immovable throughout the early and mid-1980s. Neither the securities industry, *Keidanren*, the Diet, nor the United States of America could induce the MOF to take action. Without action by the MOF, a commercial paper market could not develop. A private institution taking action on its own, as Bankers Trust did in the United States, was simply inconceivable. In short, the Japanese preference for resolving all relevant conflicts at the preclearance stage gave the agency responsible for clearance a virtual stranglehold on the initiation of the decision-making process. The Japanese ideal of consensus made MOF's decision-making rational and orderly once it began, but it also made the process difficult to start as long as the MOF or its principal interest group, the commercial banks, did not want it started.

The concept of efficiency involves the cost required in reaching a particular result. One might attempt to measure the cost of the Federal Reserve and MOF decisions in terms of the general social goal of wealth maximization, but that is simply too difficult, and would carry us far beyond the scope of a study on government decision-making. For our purposes, efficiency simply means the costs involved in reaching whatever result was reached. The conventional wisdom, reflected in Derek Bok's charges, is that the American process is less efficient because of the high cost of litigation.<sup>219</sup> Once again, however, this is much too facile. Both systems are costly in the sense that real social resources are devoted to them. The costs of the American postclearance system are more obvious, but that is simply because they are more public. The costs of litigation—the expensive attorneys, the voluminous briefs, the elaborate hearings—are there for all to see. In Japan, such public displays of disaffection are assiduously avoided, but doing so is itself a costly process. If the conflict is to be resolved at all, there must be extensive meetings, conferences, and social contacts with all the interested parties. Furthermore, experts must be carefully selected and consulted to confer legitimacy on the clearance decisions.

There is, moreover, an element of patterning which increases costs in both systems. Patterning is meant to describe the phenomenon whereby each step in a decision-making process comes to resemble the whole of the process. The phenomenon results from the fact that the totality has moral force; it represents the society's

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<sup>219</sup> See *supra* note 8.

general image about the right way to make decisions, and thereby operates as a consciously available ideal for the decision-makers who design each stage. Thus, in the United States, each separate stage of a segmented postclearance process becomes segmented itself. There are hearings and decisions on preliminary motions, interlocutory appeals, and preliminary decisions. When the Federal Reserve Board failed to act on the SIA complaint, the SIA followed with a formal petition, triggering a final decision. This was a rather expensive way to initiate the clearance decision that was, in the American model, only the first stage of an extended process. In Japan, on the other hand, the preference for preclearance conflict resolution tends to generate preliminary negotiations prior to meetings that are themselves preliminary. The purpose of the *shingikai* (study group) meetings, for example, was to lay the groundwork for the ultimate clearance decision. The participants, however, were unwilling to come into open conflict at these purportedly preliminary meetings. Thus, each meeting was preceded by extensive negotiations, discussions and informal contacts, often occurring over expensive dinners or in other costly settings, that increased the cost of the decision-making process generally. Similarly, substantive decisions were forced further down the administrative hierarchy because any open conflict or disagreement at the higher level was deemed unacceptable.

Another argument in favor of the conventional wisdom that postclearance conflict resolution mechanisms are less efficient involves the costs that the decision imposes upon private parties. The lack of finality in the American decision that constituted clearance undoubtedly imposed certain costs, as uncertainty about legal rules will generally do. But this does not mean that the period of uncertainty will always be longer in a postclearance system. A particular matter can be under consideration as long or longer at the preclearance stage, during which a similar uncertainty will prevail. In fact, the decision-making process occupied approximately the same length of time in the U.S. and Japan, as measured from the time the issue was raised until the time a sense of final resolution was achieved.

There is, moreover, a countervailing phenomenon that may reduce the cost of postclearance conflict resolution to private parties. In the preclearance scenario, where the crucial decisions occur in private, one party or industry group can readily possess superior information about the final outcome. This will tend to produce anticompetitive effects, and increase total costs to private

parties. When issues are resolved in the open, public forums characteristic of postclearance resolution—and assuming the decision-makers are honest, as they generally are in the U.S. and Japan—the parties will have essentially the same chance of predicting the outcome.

Another element of a decision-making process, apart from its internal features such as coherence, responsiveness, and efficiency, is its relationship to outside actors. Part of this relationship can be captured by the notion of political accountability. In both Japan and the United States, the primary decision-maker—the one responsible for clearance—was an administrative agency staffed exclusively by appointed officials. In both nations, moreover, the agency was answerable to the legislature. This was true in Japan because it has a parliamentary system, and it was true in America, despite our presidential system, because the Federal Reserve is an independent agency.<sup>220</sup> In both countries, moreover, the agencies were implementing an explicit statutory scheme. As a result, political accountability can be measured largely by the extent to which the legislature and the statutory scheme controlled the decision-making process.

As we have noted, both Japan and the United States operate under statutes which broadly separate commercial and investment banking, although as the commercial paper dispute vividly illustrates, the separation is breaking down in both countries. Nevertheless, our study reveals subtle differences between the Japanese and American approaches to statutory interpretation. While combinations between banks and industrial firms are illegal in Japan as in the United States, banks in Japan have used informal networks of contacts, traditions, and cross-ownership to maintain the *keiretsu* that continue to perform many of the same functions as the pre-war *zaibatsu* combinations of banks and industrial firms. Similarly, banks in Japan are prohibited from operating securities affiliates by virtue of the Antitrust Law, which effectively bars holding companies of any sort. Yet as we have seen, Japanese banks do maintain de facto securities affiliates, again through informal mechanisms of control. In addition, although article 65 expressly prohibits banks from underwriting securities, banks in practice do underwrite

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<sup>220</sup> We do not address here the vexing constitutional question underlying the concept of "independent agencies." See, e.g., Miller, *Independent Agencies*, 1986 SUP. CT. REV. 41 (discussing the constitutionality of independent agencies).



corporate bonds by making a "moral commitment" to the issuer to purchase any unsold securities and cover issuer defaults.

There are, in other words, extra-legal, or "moral" arrangements in Japan that, in practice, appear as binding as any legal contract, and that allow banks to circumvent some of the putatively applicable statutory commands. These moral commitments are characteristic preclearance mechanisms in that they depend on a private system of incentives and enforcement rather than on any threat of resort to the courts. The official, apparently binding command of the sovereign is respected in form, but in substance may be subordinated to more informal arrangements.

Based on the data we studied, it would appear that in the United States, the legislative commands regarding bank securities activities carried somewhat more force than the analogous rules in Japan. American courts define their task as enforcing the "intent" of the enacting legislature. In commercial cases especially, American courts have occasionally stepped in to overturn private arrangements that preserved the appearance of allegiance to the statutory command while in substance circumventing the law.<sup>221</sup> American courts may even insist on adherence to the statutory language when an administrative agency has proposed a different reading; *Bankers Trust I* is an example.<sup>222</sup> And American courts will sometimes enforce a statute in the face of seemingly perverse results,<sup>223</sup> at least as long as the outcome is not absurd.<sup>224</sup> These are interpretative doctrines characteristic of a postclearance system of dispute resolution, in that the publicly-announced sovereign command is given greater weight in the determination of applicable rules than

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<sup>221</sup> See, e.g., *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 690 (1985) (holding that stock transferred pursuant to the sale of a business is a "security" for purposes of the Securities Act of 1933 and the Securities and Exchange Act of 1934); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946) (stating that the definition of "security" under the Securities Act of 1933 requires that form be disregarded for substance and that emphasis be placed on the economic reality of the instrument).

<sup>222</sup> See *Bankers Trust I*, 468 U.S. 137, 150 (1984) (rejecting the Board's view that commercial paper is not a "security" for purposes of the Glass-Steagall Act).

<sup>223</sup> See, e.g., *Tennessee Valley Auth. v. Hill*, 437 U.S. 153, 194 (1978) (stating that the function of the Court is to discern the meaning and intent of enacted statutes and to apply them accordingly, rather than to balance the equities between the litigants).

<sup>224</sup> See, e.g., *Public Citizen v. United States Dep't of Justice*, 109 S. Ct. 2558, 2565-67 (1989) (stating that it would be absurd to interpret the word "utilize" in the Federal Advisory Committee Act to extend the Act's requirements to any group of two or more persons from whom the President or an executive agency had sought advice).

informal understandings that might have evolved among the parties to the rules.

We do not mean to overstate this distinction as it applies to legislative interpretation. Private arrangements often do receive sanction in the United States, even when they might appear inconsistent with the purposes of the enacting legislature—as illustrated by *Bankers Trust III* and *Bankers Trust IV*, decisions that allow U.S. banks to operate large-scale securities affiliates despite the apparent intent of the Glass-Steagall Act. Conversely, the statutory language and perceived intent of the legislature are important in the Japanese system. The difference is subtle, and one of degree rather than kind. Moreover, the present study considers only a statute that was in effect imposed on the Japanese by the American occupation forces; it is possible that the Japanese response to an indigenously-generated statutory command might be quite different from that observed here. Nevertheless, we believe that the distinction between preclearance and postclearance does have explanatory value as applied to statutory interpretation in the two countries. This suggests that American administrative decision-making is more politically accountable to the non-executive branches than is decision-making in Japan. The result is not surprising, but its link to preclearance decision-making styles is significant.

A final consideration, which involves another aspect of the decision-maker's relationship to outside actors, is fairness, that is, how fully each affected party was able to make its views known and participate in the decision-making process. Where individuals are involved, we in the United States recognize this consideration as due process, and we have concluded that it offers benefits for both the accuracy of the result and the subjective feelings of the participants. The same is probably true for institutional participants such as those involved in the commercial paper conflict.

Fairness is an explicit ideal of American decision-makers, but in a number of ways the Japanese process achieved this ideal more successfully. The primary decision-maker in the United States was almost exclusively concerned with the welfare of the banking industry. While the Federal Reserve is a conscientious regulator and cannot be described as being "captured" by the banking industry, the restrictions the Fed imposes, like the latitude it allows, are designed to foster the safety and soundness of banks. Securities firms are largely outside the Federal Reserve's concern and were thus forced into the role of the decision-maker's adversary. The Fed

allowed this situation to prevail because it did not need to resolve the conflict at the preclearance stage; other decision-makers participated after the event of clearance, and the Fed played the role of advocate before those decision-makers, leaving them to provide a forum for participants like the securities firms. Given the Fed's dominant role, however, and its ability to control the result despite the presence of other decision-makers, its adversarial stance toward the securities firms left them largely excluded from the essential aspects of the decision-making process.

The MOF was placed in an essentially different position. To resolve the commercial paper conflict effectively at the preclearance stage, it was obligated to respond to the concerns of both banks and securities firms. It was able to do so because it regulated both fields and thus possessed direct channels of communication with the major industry participants. Often, the relationship between MOF officials and members of the private firms dated back to their college years, especially to the law department at the University of Tokyo from which many participants in the controversy had graduated. Large banking and securities firms also maintained good relations within the MOF by deputizing junior officers to spend a year working there at company expense. In the other direction, senior MOF officials are generally required to retire from government service at age 55, after which they often find important and profitable positions in the private sector.<sup>225</sup>

Within the MOF itself the Banking Bureau and the Securities Bureau came into intense competition over the issue of commercial paper. Both bureaus viewed their mandate, in part, as representing the interests of their industry segment within the MOF. At the same time, the MOF's internal policy is to move policy-making officers from bureau to bureau every two or three years. Thus, MOF officials do not come to identify their personal interests totally with the interests of their bureau; the extensive circulation of individuals from bureau to bureau allows the development within the MOF of a network of relationships that permits a form of preclearance within the agency. Thus it was possible for the fundamentals of the commercial paper compromise to be established by a simple process of negotiation between banking and

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<sup>225</sup> The process is known colloquially as "*amakudari*" (descent from heaven). See E. REISCHAUER, *supra* note 1, at 187 (noting that "[i]n a ministry, when one of the members of a class reaches the top bureaucratic post of vice-minister probably in his early fifties, all the others must be retired").

securities bureaus, without the intervention of any outside force.<sup>226</sup>

The MOF's ability to respond to the concerns of all participants was not simply the product of its broader jurisdiction, but represented a conscious decision-making strategy. This is demonstrated by the existence of another group of participants who lay outside of the MOF's jurisdiction—the industrial firms that would become the major issuers of commercial paper. In Japan, their presence was felt through *Kaidanren*, essentially their trade association, and through the formidable agency that possessed regulatory jurisdiction over their activities, MITI. The MOF was able to include MITI in its decision-making process, and thereby respond to groups that are outside its jurisdiction. Certainly, the groups MITI represented did not have as much influence as the banking or securities industries, but they did have a channel for expressing their views, which is more than was available in the United States.

Thus, the Japanese process seems more fair than the American one, despite the fact that fairness is an explicit value of American decision-making, and a principle by which our decision-making process is designed. But the American process is just as coherent and probably more responsive to changing circumstances, even though these characteristics are an explicit ideal in Japan. Perhaps the irony is too tempting here and suggests caution about these conclusions. The main point, however, is that decision-making is a complex process, and one cannot take a nation's statements about itself, either positive or negative, at face value. This leads us to our final question, namely, the extent to which differences in decision-making strategy reflect differences in culture.

### C. *The Influence of Culture*

As we have seen, neither preclearance nor postclearance conflict resolution is obviously superior as a decision-making strategy. Each has its virtues, and each has its disadvantages. More important, perhaps, is that the differences between them are subtle ones; both strategies exhibit roughly similar abilities to handle complex

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<sup>226</sup> One set of relationships was not marked by extensive networks of informal contacts: those between the banking and the securities industries themselves. Those relationships were apparently conceived of as fundamentally rivalrous, so that the maintenance of contacts would have been fruitless. Industry officials we talked to indicated that a private settlement of their dispute without the intermediation of the MOF would be virtually inconceivable.

administrative problems. This suggests that the choice between them may indeed be a matter of cultural preference, and not an indication that one nation is more rational or more efficient than the other.

Other studies of Japanese and American society suggest that their choices of decision-making strategies are reflections of much broader cultural styles.<sup>227</sup> The Japanese concern with consensus and their desire to avoid open conflict are well-documented.<sup>228</sup> Perhaps they derive from the homogenous and highly-centralized nature of Japanese society, its need is to find modes of cooperation in a densely-populated region, and its emphasis on tradition and efficient governance as sources of legitimacy. America, in contrast, displays a penchant for formalized decision-making and structured confrontation, perhaps a product of a pluralistic, widely-dispersed society that derives its legitimacy from concepts of law and individual autonomy. Generalizations of this sort are dangerously malleable, but the basic pattern has been repeatedly observed.

Despite the possible cultural origin of the Japanese and American decision-making processes, one cannot simply conclude that we are dealing with two different kinds of human beings. To assess the similarity or difference between decision-makers in Japan and the United States, we must decide whether differences in culture operate as a conceptual framework or a situational context. If they operate as a conceptual framework, then people in the two countries really are different in an essential way. They think differently, and strategies that come naturally to one people are literally inconceivable to the other. The Japanese themselves often take this position. A number of the people we interviewed stated that it would simply be inconceivable for a bank to begin issuing commercial paper without regulatory approval, the way Bankers

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<sup>227</sup> See, e.g., E. REISCHAUER, *supra* note 1 (noting that "the dictatorial power of the occupation and the dire economic conditions of the time produced . . . a more comprehensive and delicate system of cooperation between government and business than had ever existed before"); P. TASKER, *supra* note 1, at 47 (remarking that "the strength of the consensus model is . . . a habit of thought shared by households, bureaucrats, managements and workers, confirmed by the systems and customs by which the social group functions").

<sup>228</sup> See, e.g., E. REISCHAUER, *supra* note 1, at 188 (stating that "[i]f the Japanese have a special decision-making process, it is the system of careful and extensive consultation before a decision is arrived at by general consensus"); P. TASKER, *supra* note 1, at 68 (stating that "[i]mportant decisions are made at middle-management level through a process of consensus-building").

Trust did, or for a trade association to sue a regulator, which the American SIA did quite often, and with enthusiasm.

But culture may also operate as a situational context in which decision-makers and decision-making agencies must function. Given a culture that generally values consensus and that has organized its institutions around compromise, a rational decision-maker would seek to achieve its goal through compromise and consensus. This behavior might not stem from an inability to conceive of alternatives, but rather from a recognition of the prevailing realities. It would have been senseless for the MOF to abandon its study groups, eliminate its carefully established network of industry contacts, release its control of the process, and seek a resolution in court. The MOF had a system of conflict resolution that worked reasonably well, and there was no good reason to dismantle it. Similarly, the Federal Reserve was prepared to reach an initial decision in response to an industry complaint, and then defend that position in court. There was no reason to establish an elaborate system of negotiation, since the Fed would probably have been sued anyway, perhaps by both sides instead of one. Moreover, efforts to negotiate with industry representatives might have been seen as illegitimate *ex parte* contact or unsavory overinvolvement with private interest groups.

Proponents of the cultural approach could argue that the rational decision-maker model fails as an explanation because it artificially isolates the decision-maker from its surroundings. The norms of decision-making in Japan and America are different because the two cultures are different; to posit the entire, pre-existing culture as a given, and then look at a single, isolated decision may not make much sense. But there is a certain validity to this approach from the decision-maker's perspective. If the decision-maker's conceptual framework is totally structured by cultural norms, alternative strategies will not even be considered; they will be inconceivable in a very real sense. In contrast, if the decision-maker is choosing, as a rational actor, to follow certain rules because they are cultural norms, alternative strategies will be conceptually available. For the most part, they will be rejected, but they will be considered and occasionally adopted. In other words, when culture operates as an external constraint, rather than as a conceptual framework, its control is looser, its admitted suzerainty less absolute.

As might be expected, the commercial paper conflict indicates that both situations occurred: the decision-makers were rational

actors on some occasions and cultural actors on others. Our Japanese informants said that litigation against the MOF was inconceivable, but the very fact that they could say it meant that they could conceive of it at some level and simply regarded it as very, very inadvisable. In fact, the securities firms apparently did try to circumvent the MOF's decision-making process by appealing directly to the Diet. Had the Diet acted, that would have constituted the event of clearance, and MOF implementation of the new statute would have constituted a series of postclearance events. The securities firms knew that Diet action was unlikely, but they appealed to the Diet in order to put pressure on the MOF. Essentially, they could conceive of and use alternative strategies. Conversely, the Federal Reserve was in contact with the securities firms, and was willing to compromise by placing restrictions on the commercial paper activities of banks. A preclearance resolution was presumably conceivable in this situation, and we know that such solutions are often reached by American regulators.

In the final analysis, however, distinctive cultural patterns did prevail. The Japanese resolved the issue in private, through a series of preclearance negotiations within a single agency, while the United States resolved the conflict through a succession of administrative and judicial adjudications of a relatively formal and adversarial character.

Thus, there is no simple answer to the debate between cultural and rational actor explanations of American and Japanese decision-making. The reason is that both systems of explanation acknowledge the crucial role of the institutional setting in which decisions are made. For cultural theorists, the institutional setting is the embodiment of culture, and particular decisions reflect that same culture in a fashion that makes them continuous with, and indistinguishable from, their setting. For rational actor theorists, the institutional setting creates the framework of rewards and punishments, of opportunities and constraints, which serves as the only possible basis for evaluating action. In other words, human behavior is contextualized in a decisive way that precludes any global distinction between actions controlled by culture and actions based on independent motivations whose consequences are defined by culture.

One might attempt to retrieve crisp distinction between cultural and rational actor explanations by using them to account for the institutional context itself. Clearly, institutions are products of human behavior, and those behaviors presumably lend themselves

to cultural or rational actor explanation. The problem, however, is that there is no initial state, no moment beyond history when institutions are created and then set in motion. Thus, the behaviors that cause institutions to develop are themselves contextualized in precisely the way that precludes the distinction between culture and rational action. The commercial paper decision, although it is the subject of the present study, and can thus be regarded as occurring against a particular institutional background, was also a stage in the development of institutions that will affect further actions. Government officials and executives of banks, investment banks, and issuing corporations will have their behavior conditioned by a set of institutions which includes the new commercial paper market, or will need to take that market into consideration when determining their own self-interest, or—most likely—will do both.

Even if one were prepared to choose a primary force in shaping institutions, that choice might not determine the contours of those institutions in a decisive way. A new way of looking at dynamic systems, called chaos theory, suggests that very small discrepancies between two similar systems will tend, over time, to produce major differences—differences so great, in fact, that the end result of the two systems will have no resemblance to each other, despite their initial similarity.<sup>229</sup> Thus, a minor admixture of cultural influences in a rational action system, or rational actor influences in a cultural system, may be sufficient to destroy the predictive value of the primary explanation.<sup>230</sup>

But all of this is a dilemma only if one accepts the framework of current scholarship, that is, if one feels obligated to choose between cultural and rational actor explanations. A better approach is to regard these two models of explanation as alternative means of accounting for observed phenomena. One can apply each in turn, or better still, one can apply them simultaneously, and accept accounts that can be justified only by both explanations. This recognizes the fact that we perceive behavior in both cultural and rational actor terms, and that the actors themselves respond to both types of motivations.

We have proposed precisely this kind of dual explanation for the distinction between Japan's preclearance conflict resolution and American's postclearance approach. The distinction emerges from

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<sup>229</sup> See generally, B. MANDELBROT, *THE FRACTAL GEOMETRY OF NATURE* (1977); H. PETTGEN & P. RICHTER, *THE BEAUTY OF FRACTALS* (1989).

<sup>230</sup> See J. GLEICK, *CHAOS: MAKING A NEW SCIENCE* 59-80 (1987).



the cultural proclivities of executives and officials in the two nations, but each mode of behavior made sense to the participants in rational terms, and could be justified in those terms. This dual approach does not abandon the enterprise of explanation, but rather increases its possibilities. By using both approaches, we can treat individuals as rational actors, whose behavior is predictable at the individual level and comprehensible to other human beings from different cultures. At the same time, we can discern general patterns that distinguish cultures, and that reflect differences in attitude as well as circumstances.

Simultaneous explanation is particularly important when dealing with sophisticated nations that interact with one another. To account for interactions of this nature, one must recognize cultural difference and yet allow for comprehension and learning between cultures. This is certainly true of the commercial paper decision. Japanese and American decision-makers were aware of each other's actions, and their own behavior was affected by that knowledge. At the technical level, the Federal Reserve knew that America's major commercial competitors, including Japan, allow their commercial banks to engage in a wider range of securities activities. Its decision to authorize the Bankers Trust program, therefore, was partially designed to move American banks closer to the European-Japanese mode. The MOF, on the other hand, was directly influenced by the existence of commercial paper markets in the United States and other countries, and understood the industrial firms' desire to increase their access to capital markets. Thus, each nation's decision-makers were able to learn from each other, and respond rationally to the challenges its economic rival presented. At the same time, they interpreted what they learned in their own cultural context, and offered culturally distinct responses.

More generally, decision-makers in both nations are aware of each other's decision-making styles. Derek Bok's complaints are just one reflection of the self-evaluation which any large, sophisticated society undertakes. Knowledge of other cultures provides a means of conceptualizing different approaches, of standing apart from certain culturally embedded patterns and evaluating their desirability. Decision-makers in each culture continue to evaluate other cultures from their own cultural perspective, of course, but the interplay of perspectives is capable of releasing creative energies, and improving the decision-making process according to the decision-makers' own criteria. This paper is an effort to contribute to that process of cultural self-evaluation.

## CONCLUSION

We have examined the method by which both Japan and the United States allowed banks to enter the business of underwriting and distributing commercial paper at about the same time. These developments, which are enormously significant for financial markets in both countries, present a unique vantage point for comparing and contrasting their administrative processes for dispute resolution. We find that the marketplace dynamics in the two countries were remarkably similar: in both countries, commercial paper represented a threat to the core banking business of extending short term credit to large business firms. In both countries, the banks sought to protect that core business against inroads by the securities industry. Both cases involved intense interest group lobbying, and in both, the outcome of the process was a period of cut-throat price competition between new bank entrants and the existing underwriters. Both cases were affected by globalization of financial markets, although in different ways.

At the same time, the case studies present some remarkable differences between the two countries' approaches. In Japan, the process was largely contained within the four walls of a single agency, the Ministry of Finance, although other agencies did play a marginal role. In the United States, the Federal Reserve Board played a dominant role at the agency level—a somewhat unusual situation in American banking regulation with its multiplicity of agencies—but the process was heavily influenced by the inevitability of judicial challenge to the Board's decisions and by frequent appeals to Congress to resolve the situation. In Japan, the process, although influenced by private action, was tightly controlled by the MOF, whereas in the United States, the appearance, at least, was that private firms were responsible for driving the process forward. The decision process in Japan was generally private, informal, non-litigious, and not publicly confrontational. In the United States, the process was public, formalized, litigious, and confrontational.

We proposed that these differences can be partially captured by the observation that the commercial paper controversy was resolved in Japan by means of a preclearance method, whereas in the United States, the process can be described as one of postclearance dispute resolution. We cautioned that the preclearance-postclearance distinction should not be overdrawn, in that postclearance features are evident in Japan and preclearance features are evident in the United States. Nevertheless, we believe the distinction between

preclearance and postclearance does capture something important about the differences between the two countries in their treatment of the commercial paper dispute. We speculated that the Japanese and American preferences might reflect cultural attitudes—the relatively homogenous and geographically centralized nature of Japanese culture, and the pluralistic, relatively geographically dispersed nature of American culture. At the same time, the choices made by decision-makers in the two nations might be rational responses to an existing institutional context. Neither method is necessarily more “efficient” at resolving disputes than the other; rather, each method may be better adapted to different underlying features in the society.

